Chief Investment Office GWM
Investment Research
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The CEO Macro Briefing Book

On track for a soft landing, what's next?

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Executive Summary: On track for a soft landing, what's next?

Macroeconomic Outlook

- **The US economy should slow in 2024, but maybe only modestly.** GDP grew 3.1% in 2023, above the ~2% trend rate, and the data hasn't slowed much so far in 2024. The recent easing of financial conditions may result in the economy continuing to run hot.
- **Fed rate cuts are coming, likely starting in May.** Recent Fed guidance implies that cuts won't start before May and their timing will be data dependent. Market pricing is down to 4.5 cuts in total this year, we expect 4. It's unlikely that the Fed doesn't cut because not doing so would make policy overly restrictive.

Operating Environment

- **Consumer spending should remain healthy.** A tight labor market and rising real incomes should combine for consumption growth at pre-pandemic rates. Even with labor demand cooling, lower supply growth relative to the past two years should keep the labor market from getting too loose.
- **Easier financing conditions by year-end.** Fed rate cuts with an easing bias should result in lower borrowing costs for small firms, and lending conditions that will gradually ease. They are already getting less tight, and capital is available for most borrowers.

Markets & Deal Activity

- **Goldilocks for equities, at least for now, with more market swings**. Solid growth, continued disinflation, and rate cuts are supportive for equities. Much of this good news is priced in and valuations look relatively expensive, but that doesn't prevent more upside.
- **M&A green-shoots could start to bloom once rate cuts are imminent.** Falling rates, rising confidence in the economy, and record dry powder point toward a rebound in M&A deals. The IPO market needs better performance from new issuers and increased investor interest in more speculative stocks, which requires lower rates, to open significantly.

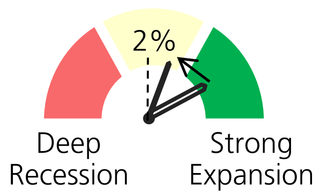
Politics

- **A historic electoral year globally**. More than 60 countries representing about half of the world's population are having elections in 2024.
- **Major US fiscal policy changes require a "wave" outcome.** Control of the House and Senate is as important as the presidential outcome for passing significant fiscal legislation. Prediction markets are at 70% for the Dems to win the House, and a toss-up for the Senate. .

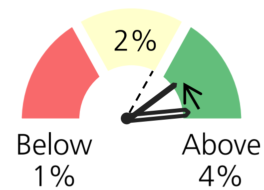
Dashboard Summary: Cooling macro to lead, rates and activity follow

Expected — Current — 6-months prior

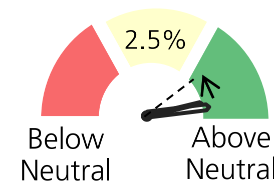
Macroeconomic Conditions



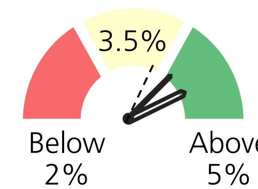
Growth



Inflation

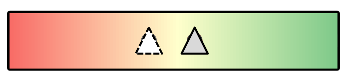


Policy Rate



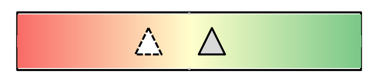
Longer-term rate

Operating Environment



Consumers

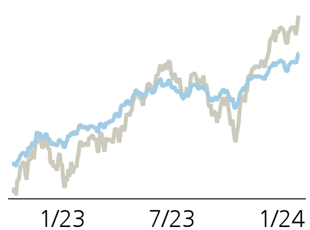
Labor



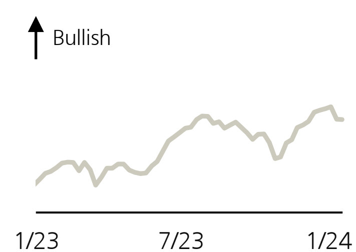
Financing

Real Estate

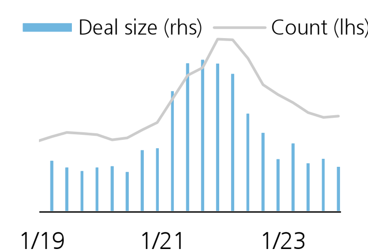
Markets & Deal Activity



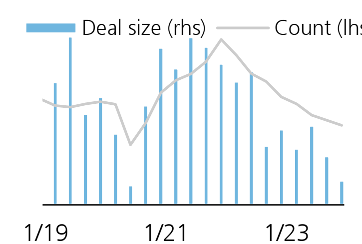
S&P 500 & NASDAQ



UBS Investor sentiment



IPO Activity



M&A Activity

UBS

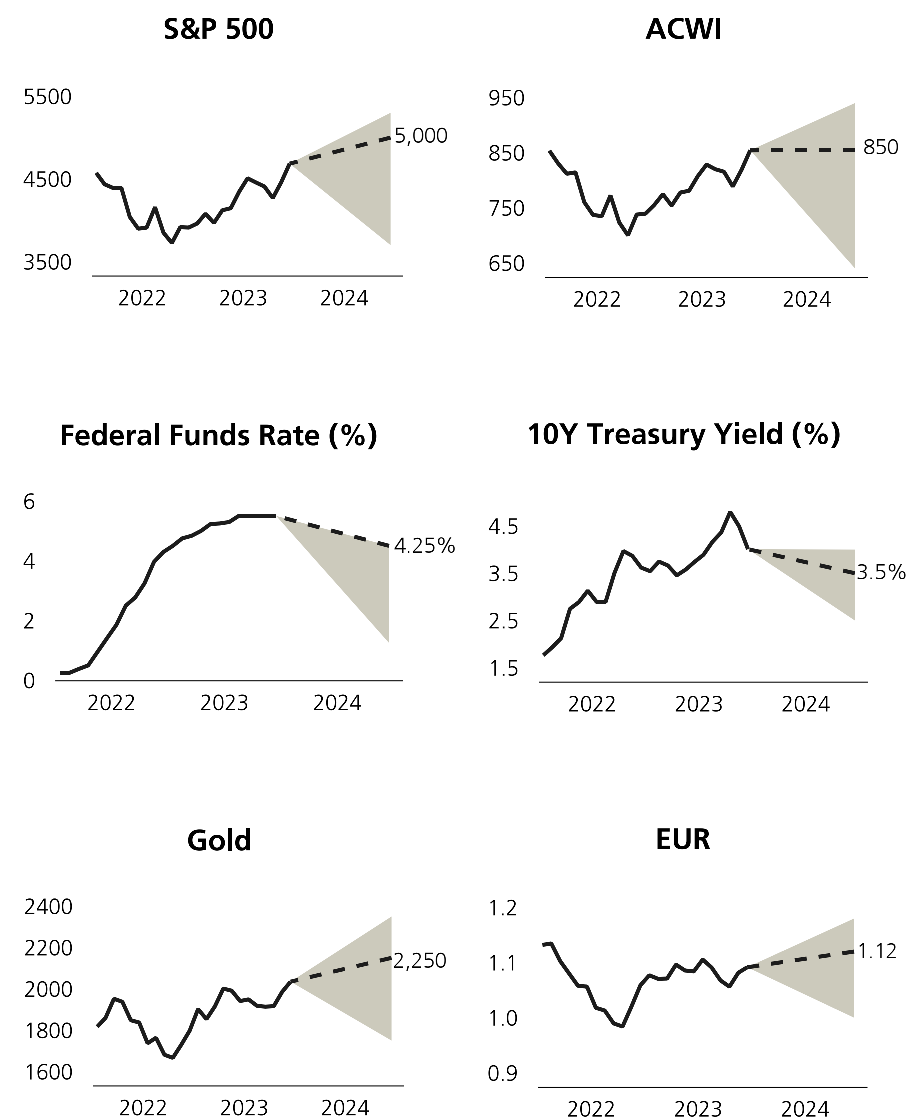
Markets Dashboard: From great to still good performance

Performance	Latest	YTD	Q423	H223	2023
S&P 500	4906	3.3%	11.2%	7.2%	24.2%
Large Cap Growth	3117	5.1%	9.7%	6.6%	28.3%
Large Cap Value	1721	1.1%	13.0%	7.9%	19.8%
US Small Cap	1974	-1.5%	13.6%	7.3%	15.1%
Int'l DM	879	2.3%	9.0%	5.9%	19.5%
S&P 500 Sectors					
Energy	636	1.4%	-7.8%	2.6%	-4.8%
Materials	527	-2.7%	9.1%	3.4%	10.2%
Industrials	972	0.2%	12.5%	6.2%	16.0%
Consumer Discretionary	1395	-1.7%	12.2%	6.6%	41.0%
Consumer Staples	788	2.1%	4.8%	-2.1%	-2.2%
Healthcare	1656	3.0%	5.9%	2.7%	0.3%
Financials	645	4.2%	13.4%	11.6%	9.9%
IT	3579	6.2%	16.9%	10.1%	56.4%
Utilities	318	-2.8%	7.6%	-3.3%	-10.2%
Real Estate	244	-4.1%	17.7%	6.3%	8.3%
US Gov't	2271	-0.8%	5.7%	2.4%	4.1%
Munis	1315	-0.9%	7.9%	3.6%	6.4%
TIPS	340	-0.4%	4.7%	2.0%	3.9%
Agency	118	-0.5%	5.6%	3.6%	5.4%
US IG	3216	-0.5%	8.5%	5.1%	8.5%
US HY	2480	0.1%	7.2%	7.7%	13.4%
Oil	73.8	8.6%	-21.1%	1.4%	-10.7%
Gold	2055	-1.3%	11.6%	7.5%	13.1%
USD	103	2.0%	-4.6%	-1.5%	-2.1%
EUR	1.09	-1.8%	4.4%	1.2%	3.1%
JPY	146	4.7%	-5.6%	-2.3%	7.6%
EM FX	1724	-0.9%	4.3%	3.8%	4.8%

Source: Bloomberg, UBS, as of 31January 2024

Negative Positive

2024 UBS CIO Forecasts



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Section 2

Macroeconomic outlook

Macro Key Points: Soft landing to a new regime, but US-only

The 2024 macro debate: A soft landing, or maybe no landing? Last year, the main debate was over a soft vs. hard landing. The clear consensus is for the US to soft land in 2024 and avoid a recession. The question is what the landing looks like, especially with resilient growth making a "no landing" possible.

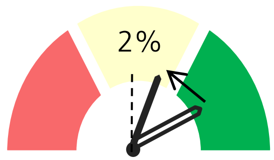
Fed rate cuts in 2024: maybe delayed, but still happening. Cuts are likely to start by May, with the risk skewed to a later start in the summer. But cuts are likely because as long as inflation continues to decline even gradually, the Fed will want to cut to prevent policy from getting more restrictive. Plus, the Fed can act aggressively on labor market weakness; i.e., the "put" is back!

Investment and business dynamism green shots could bloom … into a "Roaring '20s". A surge in policy-induced capital spending and new business formation are evidence that the post-pandemic US economy is experiencing increased dynamism and an investment surge that could result in a multi-year boost to productivity.

US exceptionalism to continue for the time being. US growth positively surprised in 2023, while much of the rest of the world slowed. That trend is continuing early in 2024, as strong momentum, households in good financial shape, and new investment all support US economic outperformance for the rest of the year.

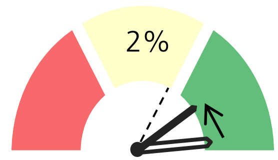
Macro Dashboard: Growth, inflation, and rates back to “normal”

Expected Current 6-months prior



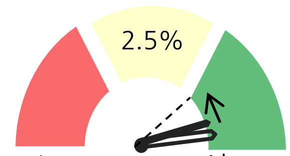
Growth

- 2H 2023 real GDP growth surprised to the upside thanks to consumer resilience; we expect a modest slowdown to around trend in 2024.



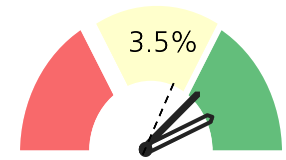
Inflation

- CPI and PCE show inflation around 3%, even lower for 6m annualized core PCE; leading indicators point to ongoing disinflation in 2024.



Fed funds rate

- The Fed ended its rate hiking cycle at 5.5%; we expect the first rate cut in May, and 100bps in total in 2024; the rate should gradually fall back to about 3.5%.



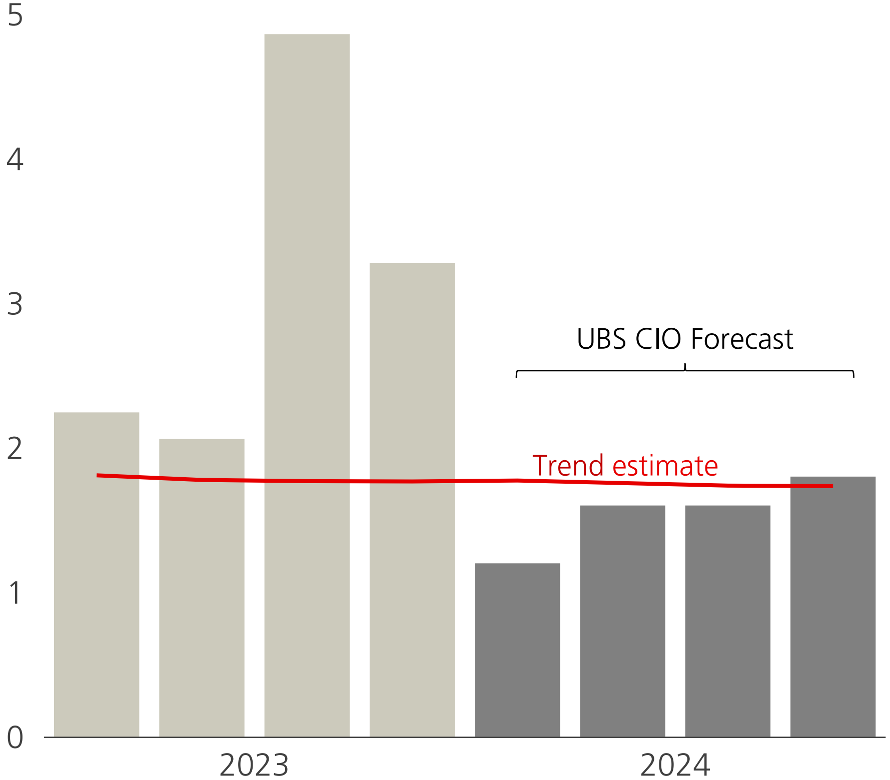
10-year yield

- After peaking at 5%, the 10-year yield should be range bound around 4%, falling later in the year once the Fed starts cutting rates.

Growth: Set to slow, but maybe not much in 2024

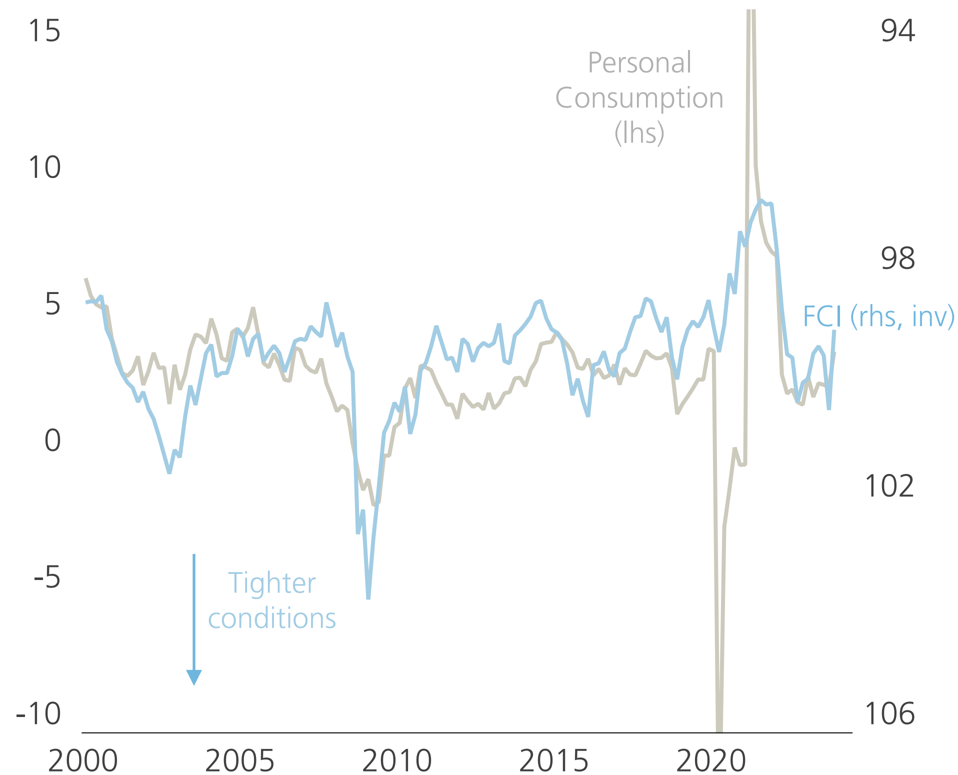
After US GDP grew 3.1% in 2023, it's likely to slow to below or near 2%; easing financial conditions late in 2023 and early 2024 reduce the odds of a recession and could cause growth to accelerate.

From well above to barely below the trend growth rate
Quarterly annualized real GDP growth rate, %



Source: BEA, UBS, as of 7 February 2024

Recent easing of financial conditions should be positive for growth
Real consumption growth, y/y in %, Bloomberg Financial Conditions Index

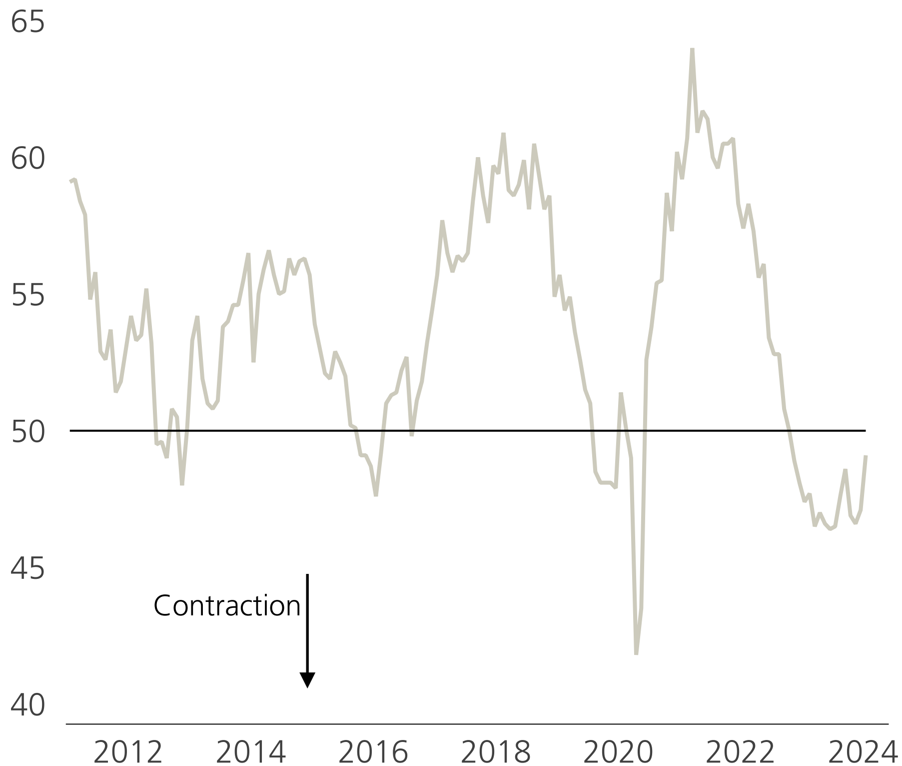


Source: BEA, UBS, as of 7 February 2024

Growth: Rolling recessions for manufacturing and housing are ending

Manufacturing and housing activity, the most rate-sensitive parts of the economy, experienced mild contractions in 2023, but both appear to have bottomed and are in the early stages of recovery.

ISM manufacturing index still in contraction but improving
Index



Source: ISM, UBS, as of 7 February 2024

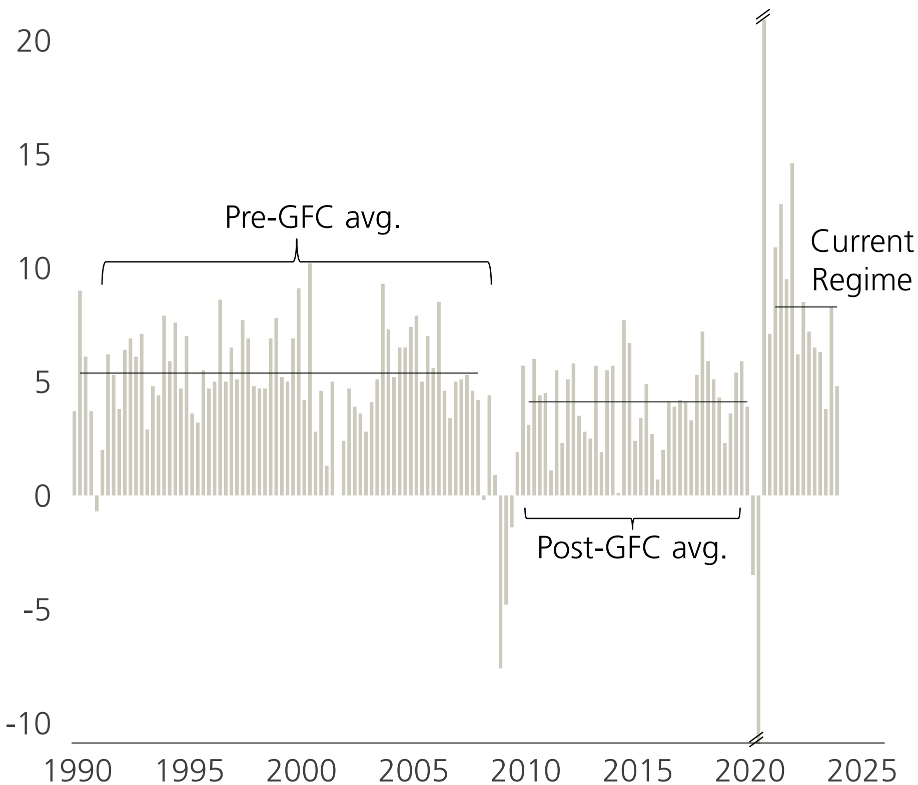
Homebuilder optimism is improving, and lower rates will help
NAHB sentiment index

Source: NAHB, UBS, as of 7 February 2024

Growth: The economy appears to be landing in a new regime

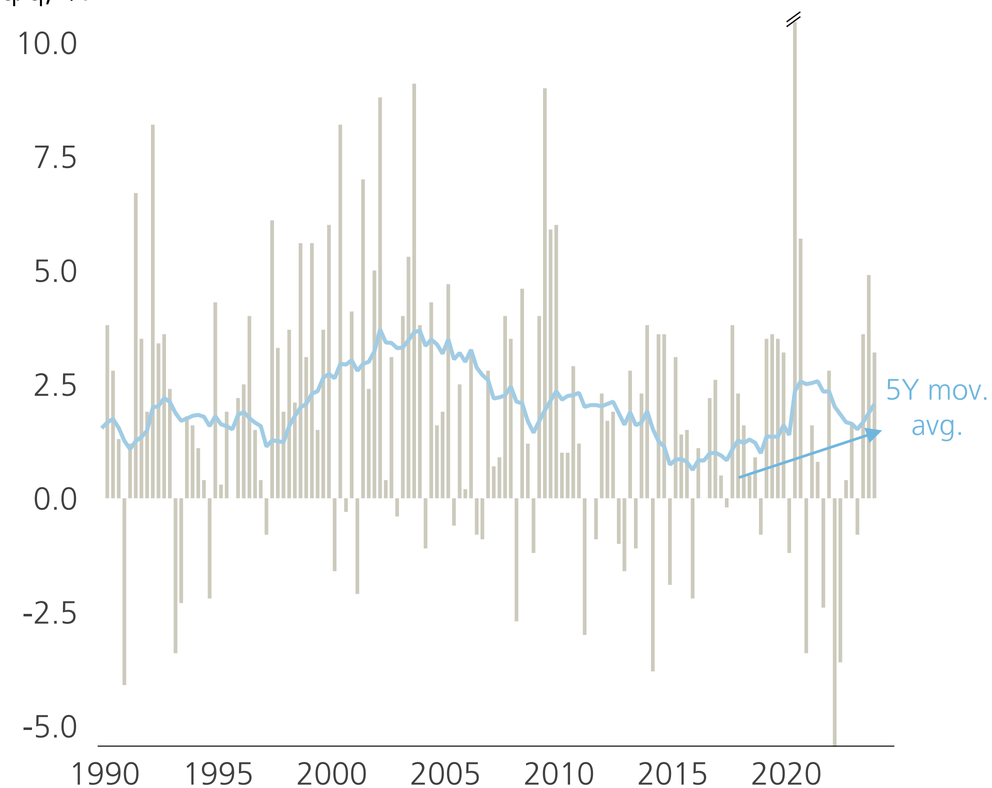
Inflation, rates, and possibly growth as well are all likely to be higher this decade than the 2010s, which could become a “Roaring ‘20s” if productivity growth stays elevated.

Nominal GDP growth defying calls for a slowdown
Quarter-over-quarter annualized rate, in %



Note: Axes have been truncated
Source: BEA, UBS, as of 7 February 2024

Productivity growth trend recently accelerating
q/q, %

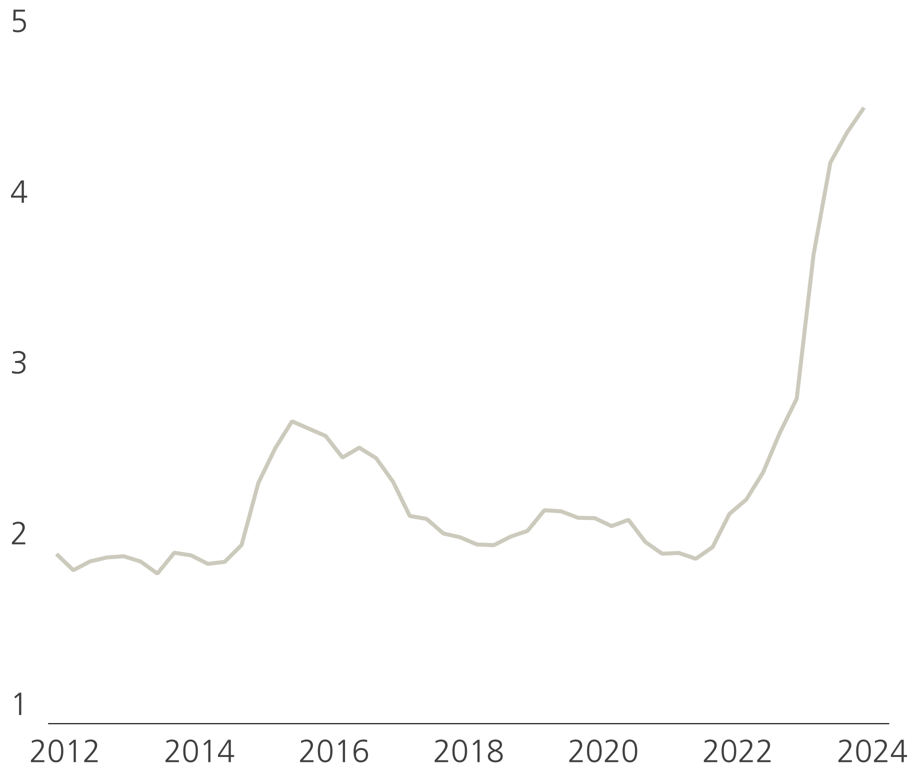


Note: Axes have been truncated
Source: BEA, UBS, as of 7 February 2024

Growth: A capex boom is possible, a tailwind to a better regime

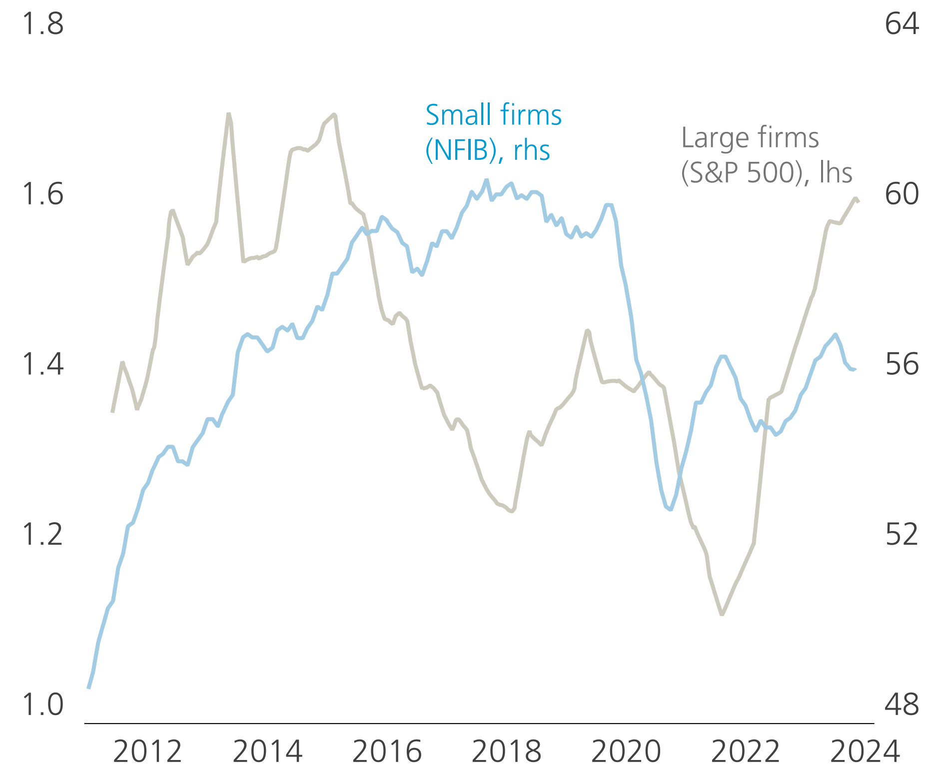
A tight labor market, an aging capital stock, a lack of investment last cycle, and a policy focus on domestic manufacturing are ingredients for capex surge, which could boost productivity.

Manufacturing investment surges thanks to CHIPS Act
% Private Fixed Investment



Source: BEA, UBS as of 7 February 2024

Larger firms leading smaller firms in capex intentions
S&P 500 capex to depreciation ratio & NFIB actual capex index



Source: Bloomberg, NFIB, UBS as of 7 February 2024

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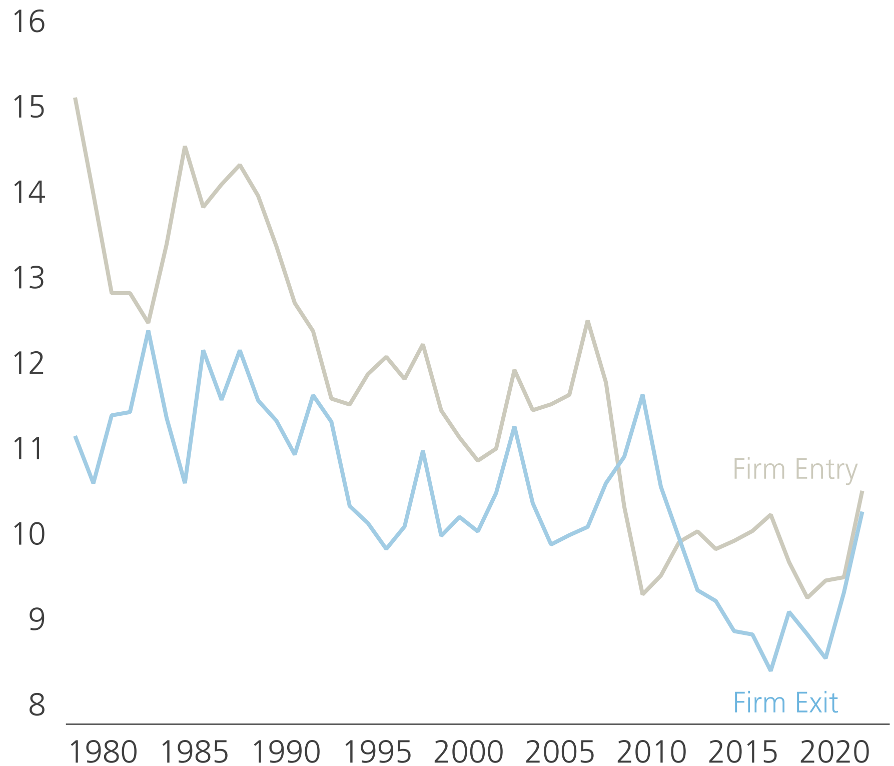
Growth: Tentative signs of increased dynamism post-pandemic

A post-pandemic surge in new business applications and a modest uptick in business churn are indicative of increased dynamism in the US economy after declining in recent decades.

Firm Entry and Exit rate has been declining for decades
%



Source: Census Bureau, UBS, as of 7 February 2024

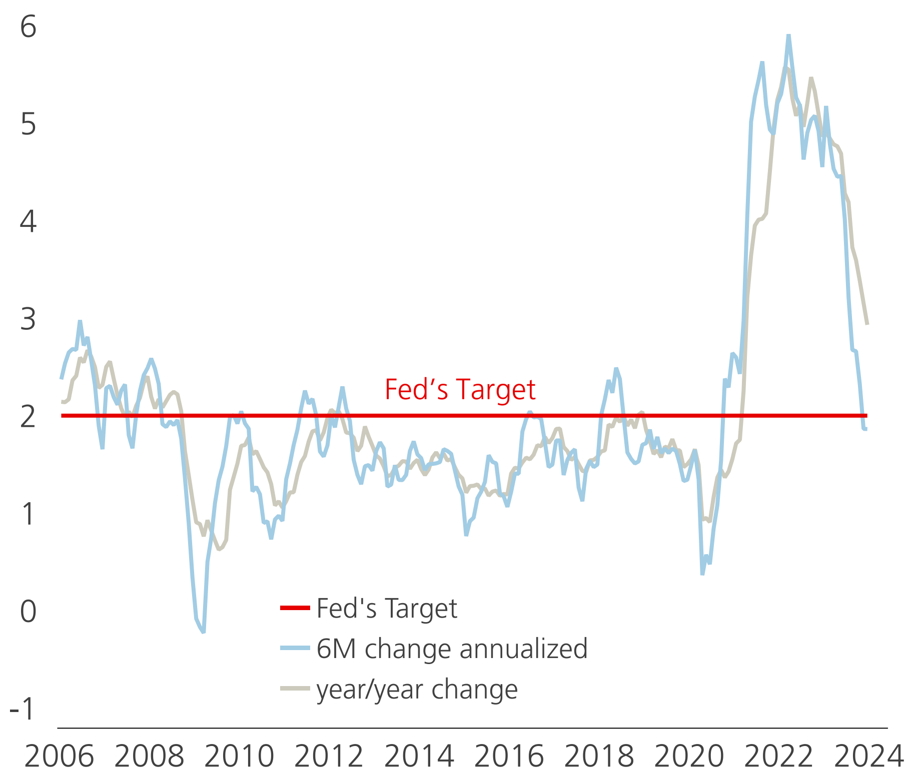
Business Formation applications structurally higher after pandemic
in '000s.

Source: Census Bureau, UBS, as of 7 February 2024

Inflation: Falling quickly to 2%, but wages declining more slowly

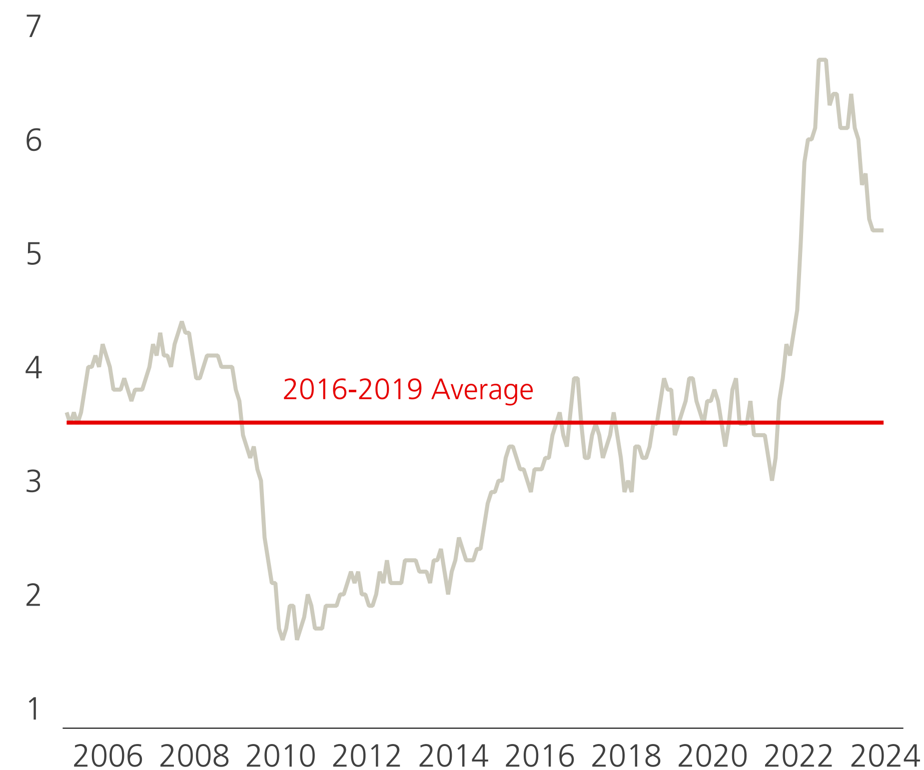
Falling inflation will give policymakers more reason to cut rates, but fast wage growth may hinder rate cut hopes.

Current pace of core PCE already below Fed's target
%



Source: BEA, UBS, as of 7 February 2024

Atlanta Fed Median Wage Tracker still running at a fast pace
year/year, %



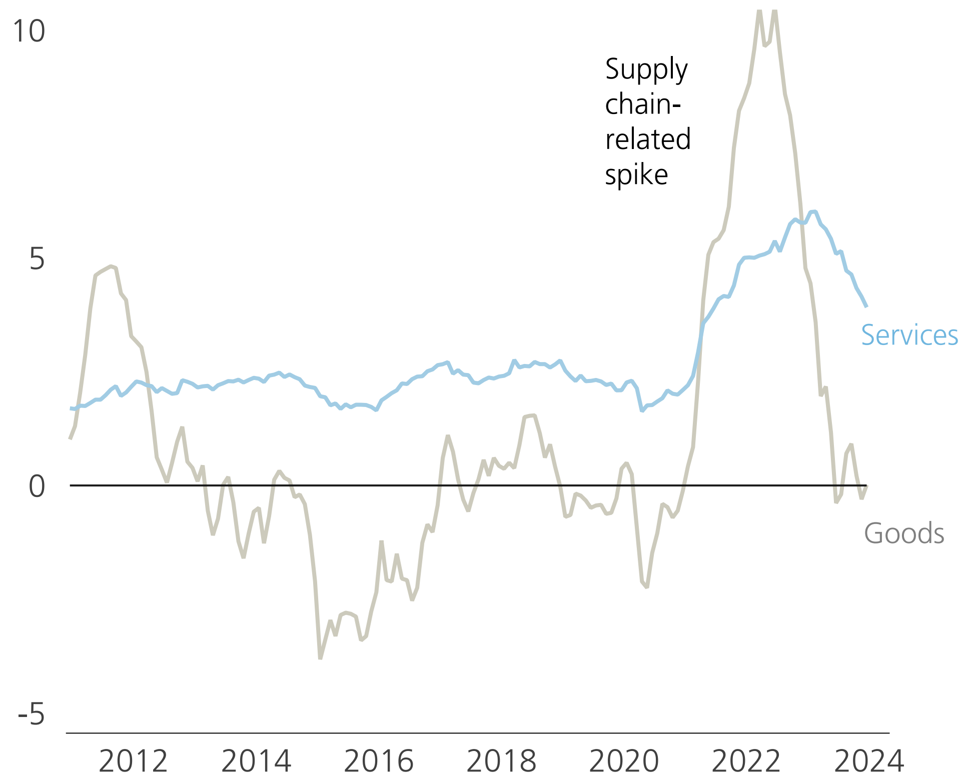
Source: BEA, UBS, as of 7 February 2024

UBS

Inflation: It wasn't even on the way up, nor on the way down

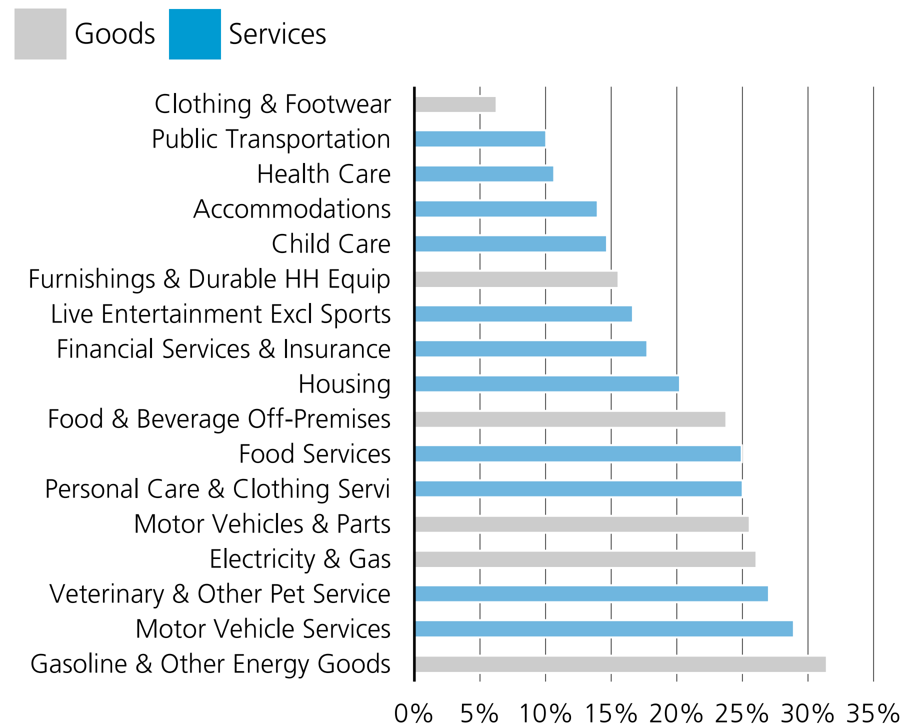
Not all prices rose equally the past few years, with high frequency items (gas and food) going up more; now at least there is some disinflation in goods, but less so in services.

Goods inflation is back to 0%, while services is still elevated
PCE inflation, year/year, %



Source: BEA, UBS as of 7 February 2024

Prices for many categories are uncomfortably higher for consumers
% change since 12/31/2019



Source: BEA, UBS as of 7 February 2024

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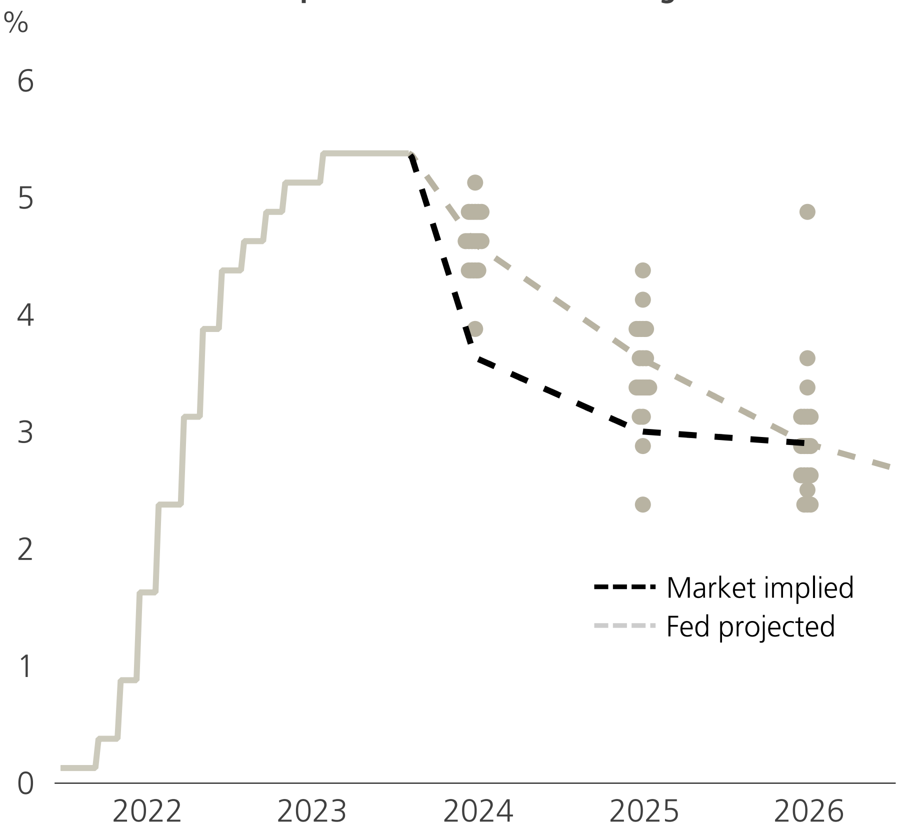
Interest rates: Even with cuts, rates likely to stay higher for longer

The 10-year Treasury yield breaking out of its 40-year down trend is consistent with the market pricing a 3%+ policy rate floor for the foreseeable future.

Actual and market-implied Fed funds rate through '26



Source: BEA, UBS, as of 7 February 2024

10Y Treasury Rates reverse a four-decade trend

Source: BEA, UBS, as of 7 February 2024

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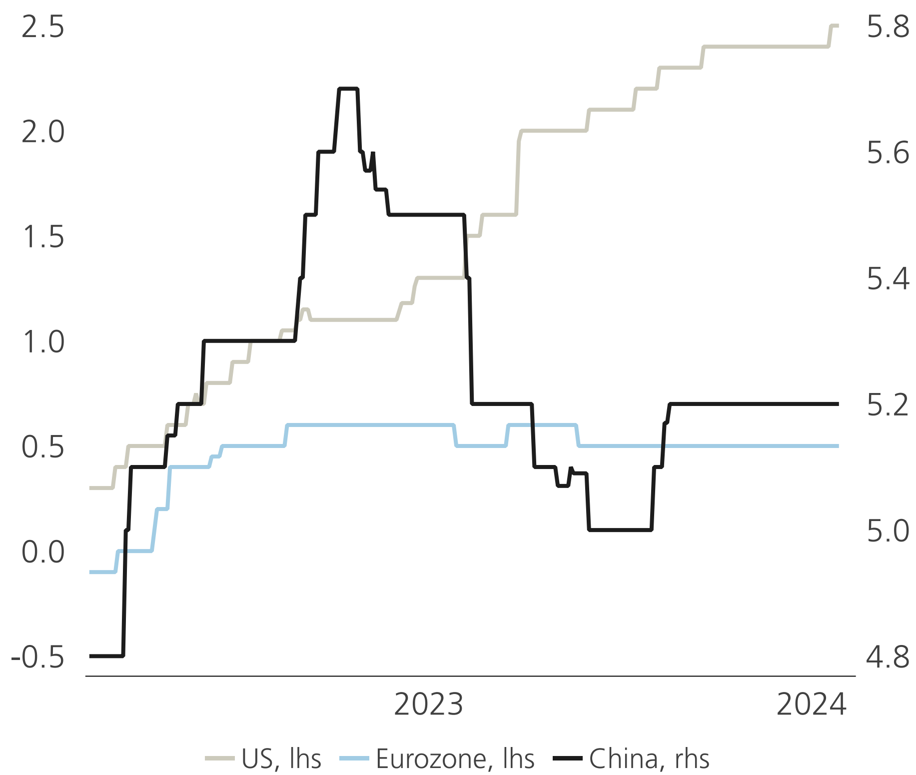
Global Growth: Shaping up to be US exceptionalism (again)

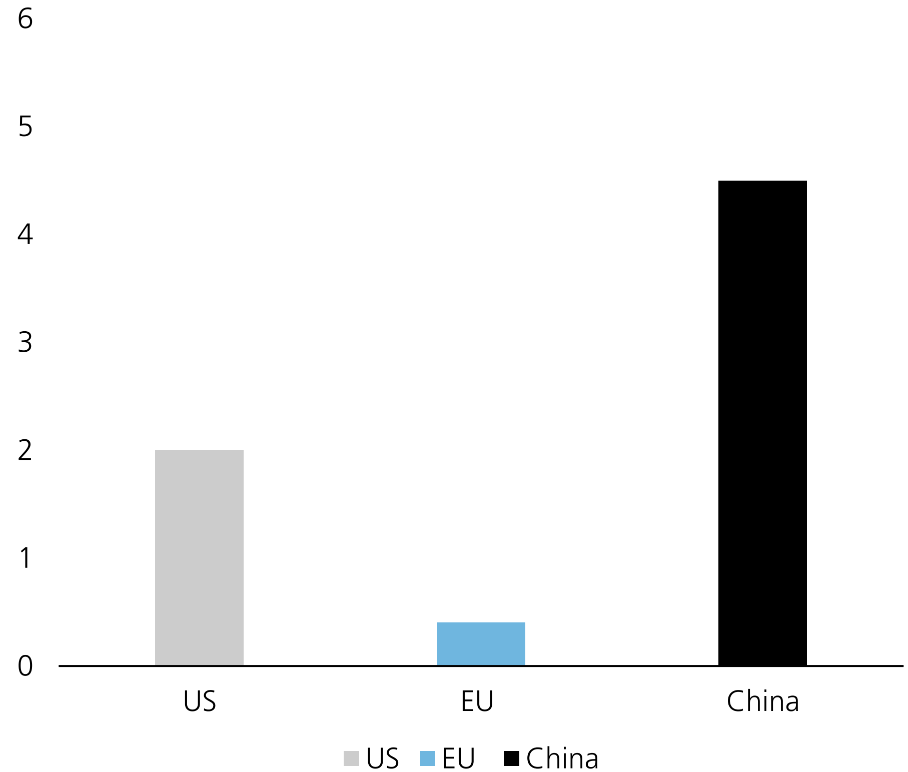
In 2023, US growth surprised most to the upside, while the EU was stuck below 1% growth and optimism on Chinese growth after re-opening soured throughout last year.

2023 real GDP Forecasts revised much higher for US versus peers
Annual rate, %



Source: Bloomberg, UBS, as of 7 February 2024

2024 UBS CIO real GDP Forecasts
Annual rate, %



Source: UBS, as of 7 February 2024

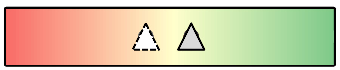
Section 3

Operating environment

Operating environment dashboard

Current 6-months prior

Bad ← → Good

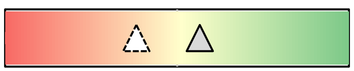


Consumers

- Over the last six months, consumer spending picks up despite a modest slowdown in personal income; consumer balance sheets still healthy in aggregate and sentiment has improved.

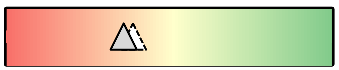
Labor

- Labor market overall very strong despite slight moderation in job openings and payroll growth. Lower quit rate reduces sense of labor shortages.



Financing

- Rate hikes from Federal Reserve and tighter lending starts have raised borrowing costs, but some interest rates have already lowered in anticipation of 2024 rate cuts.

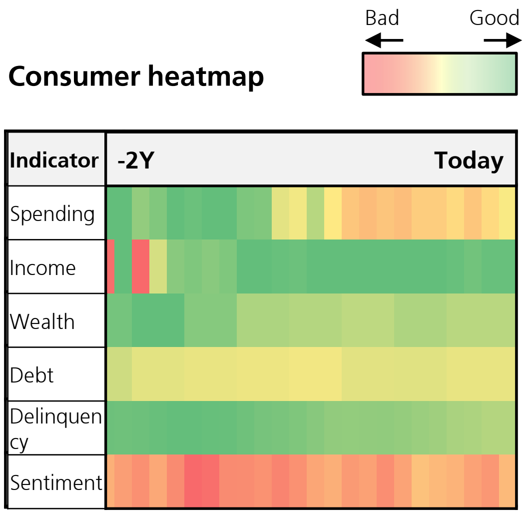


Real Estate

- Real estate conditions overall little changed over last six months; vacancy rates for residential homes still at very low levels while opposite is true for office space

Consumer Key Points: No let-up on rising incomes and sentiment

Consumer heatmap



Note: "Spending" is represented by change in retail sales; "Income" is represented by growth in personal income; "Wealth" is represented by household wealth as share of disposable income; "Debt" is represented level of debt service; "Delinquency" is represented by share of delinquent households; "Sentiment" is reflected by University of Michigan consumer sentiment index

Source: Bloomberg, BEA, Federal Reserve, University of Michigan, UBS, as of 7 February 2024

A slower but still healthy consumer in '24: Consumer spending has moderated since last summer, but we expect it to stay near long-term average growth rates. Lower income earners have disproportionately benefited in the post-pandemic recovery.

Spending has normalized, but with permanent structural shifts. Spending grew about 3% over the holidays, in-line with the pre-pandemic average. However, spending on goods appears to be structurally higher while services are still 'catching up.'

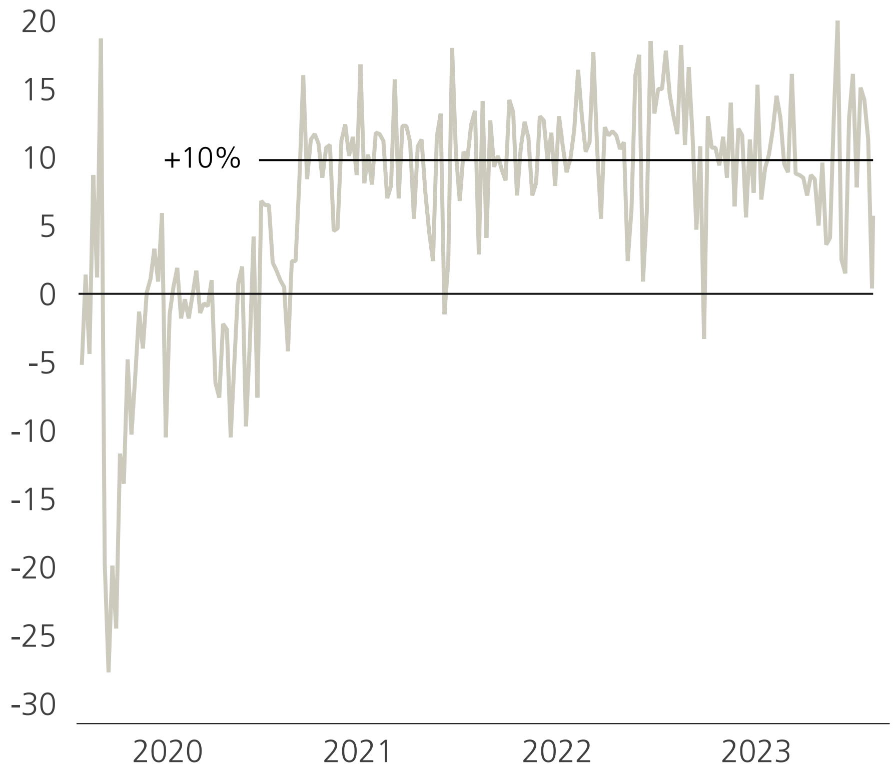
Household finances are strong, despite rising delinquencies. Household wealth is near record highs, real incomes are rising, debt to income levels are not stretched, and debt servicing is very low despite higher rates. Delinquencies on credit cards and auto loans are rising, but overall delinquencies on all borrowing are very low.

Vibecession is over, vibespansion is only beginning. Sentiment about current and future conditions is rising from depressed levels, while inflation expectations are at their lowest since early 2021.

Spending: Very robust according to micro and macro data

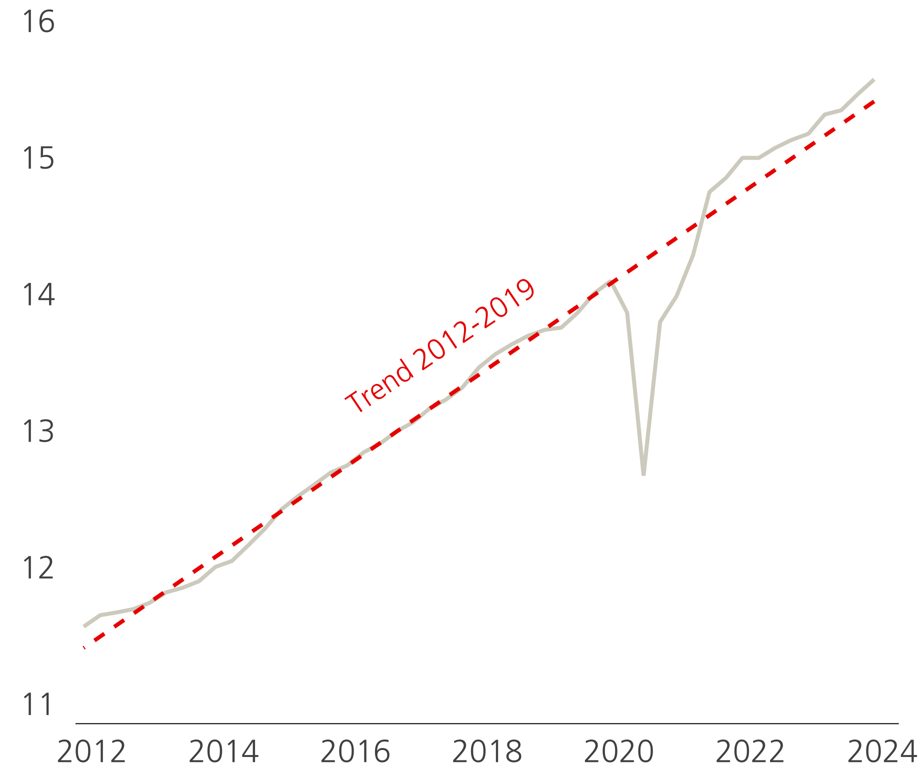
Credit card data shows post-pandemic spending up 10% compared to pre-pandemic and overall consumption is slightly higher than its pre-pandemic trend rate.

Credit card spending relative to pre-pandemic levels
Pre-pandemic baseline = 0



Source: BEA, UBS, as of 7 February 2024

Real consumption running above trend despite pandemic recession
in 2017 $T

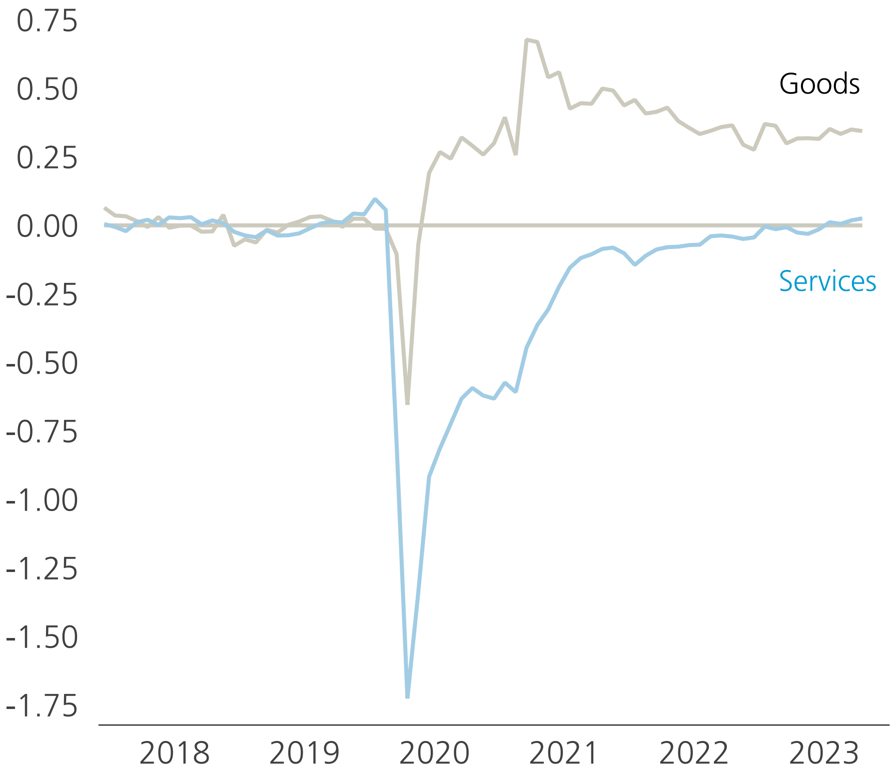


Source: BEA, UBS, as of 7 February 2024

Spending: Goods spending higher and services catching up

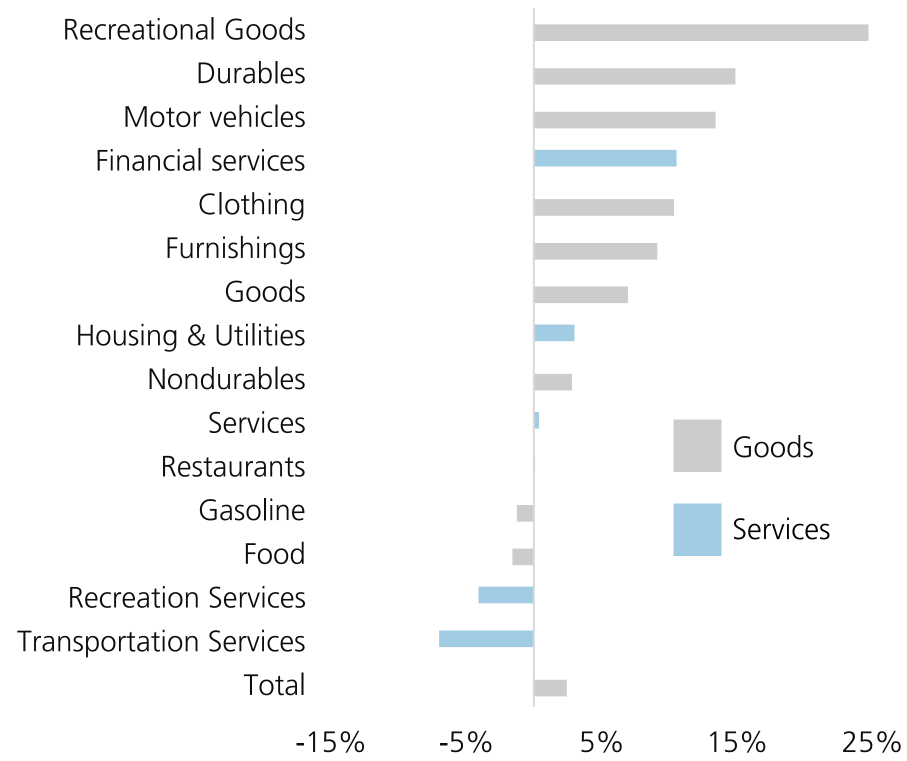
The post-pandemic spending mix appears structurally different: work at home has driven higher significant goods spending, though services spending is catching up and above pre-pandemic trend.

Real spending on goods has stayed above its 2018-19 trend
Deviation from trend, in tn. USD



Source: BEA, UBS, as of 7 February 2024

Consumer spending, especially on goods, remains robust
Real PCE relative to 2018-2019 trend, %



Source: BEA, UBS, as of 7 February 2024

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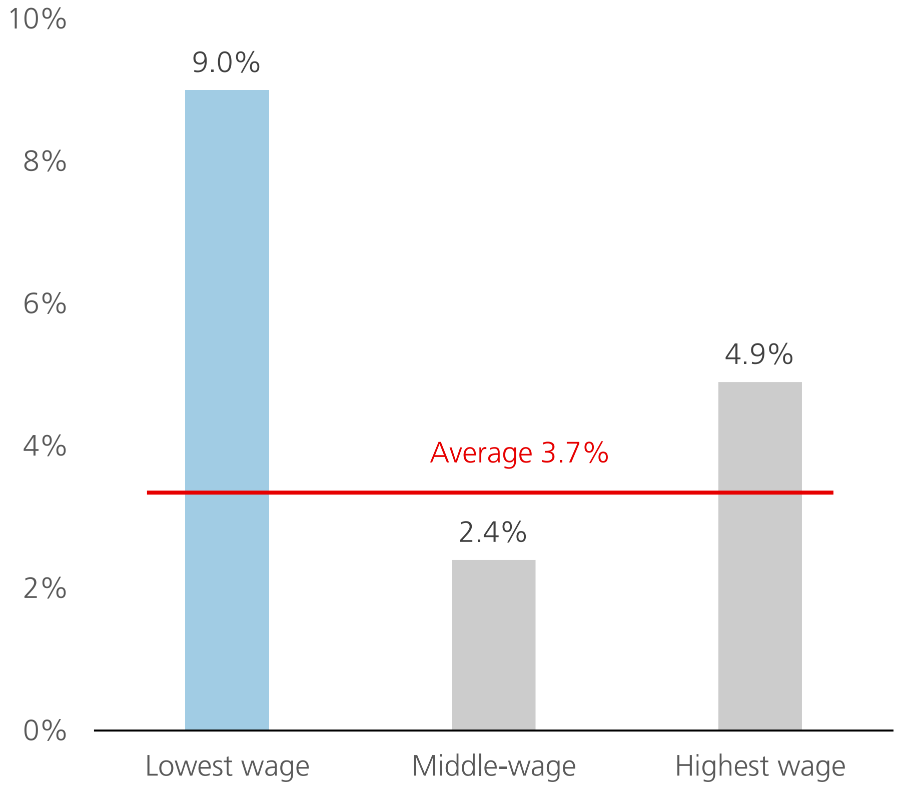
Income: Real income growth is positive and key to the soft landing

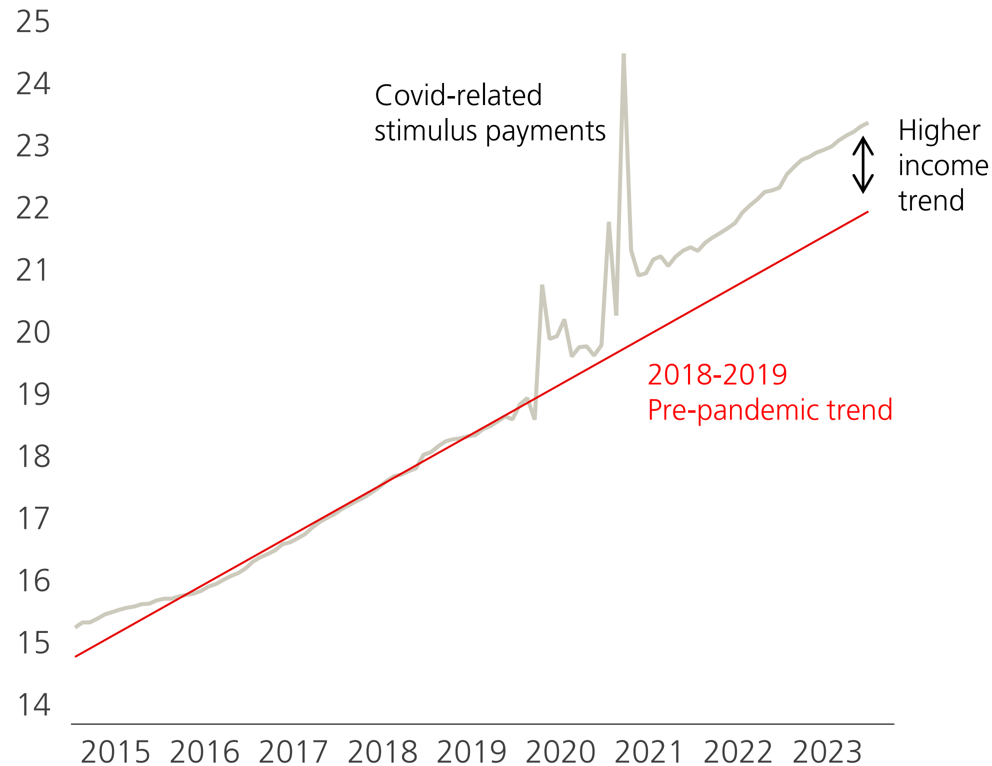
Unlike past recoveries, lowest income brackets benefited most from post-pandemic real wage gains; stimulus payments and fast wage growth push up personal income to higher trend.

Cumulative real wage gains by income bracket
2019-2022, %



Source: Economic Policy Institute, BLS, UBS, as of 7 February 2024

Personal income structurally higher thanks to pandemic stimulus
in tn. USD

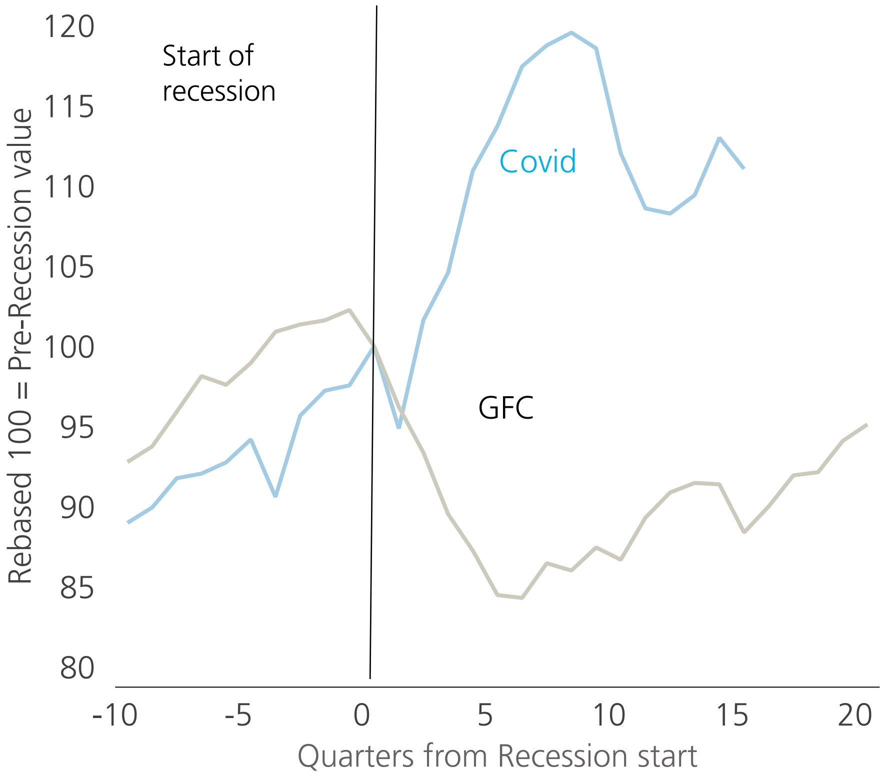


Source: Federal Reserve Bank of Atlanta, UBS, as of 7 February 2024

Balance Sheets: Households in aggregate are in very good shape

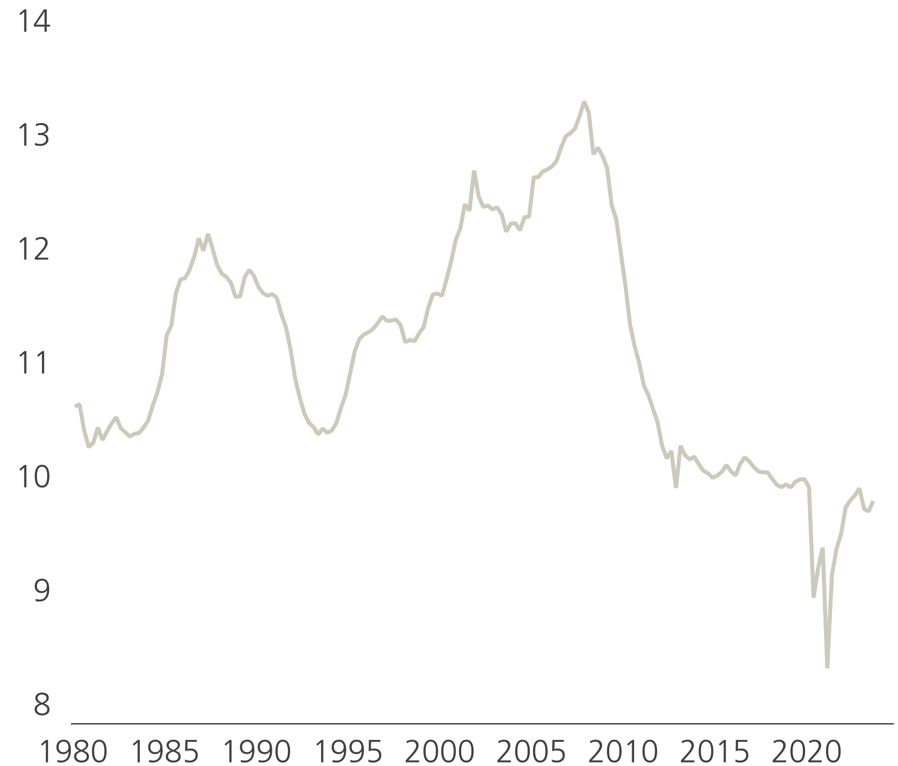
Pandemic-related stimulus supercharged the household net worth recovery and avoided the post-GFC sluggishness; despite rising rates, debt burdens of households still near historic lows.

Net worth is much higher than pre-pandemic levels
Household real net worth (pre-recession=100)



Source: BLS, BEA, Bloomberg, UBS, as of 7 February 2024

Household debt coverage is still historically low
Ratio of debt service costs to disposable income, %



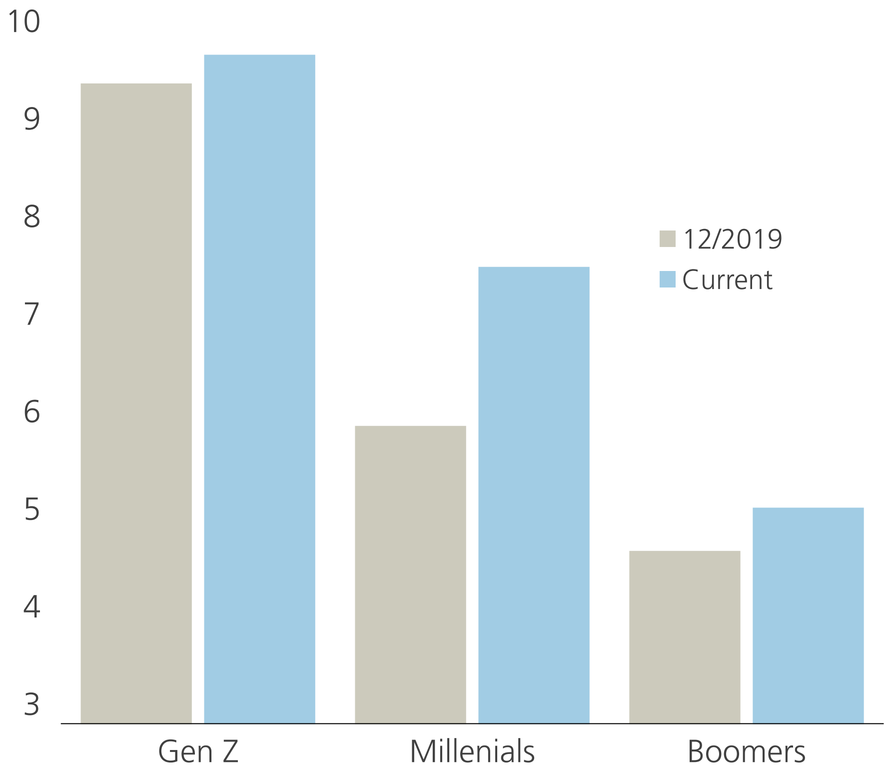
Source: Bloomberg, UBS, as of 7 February 2024

UBS

Balance Sheets: Debt burden is not nearly as onerous as assumed

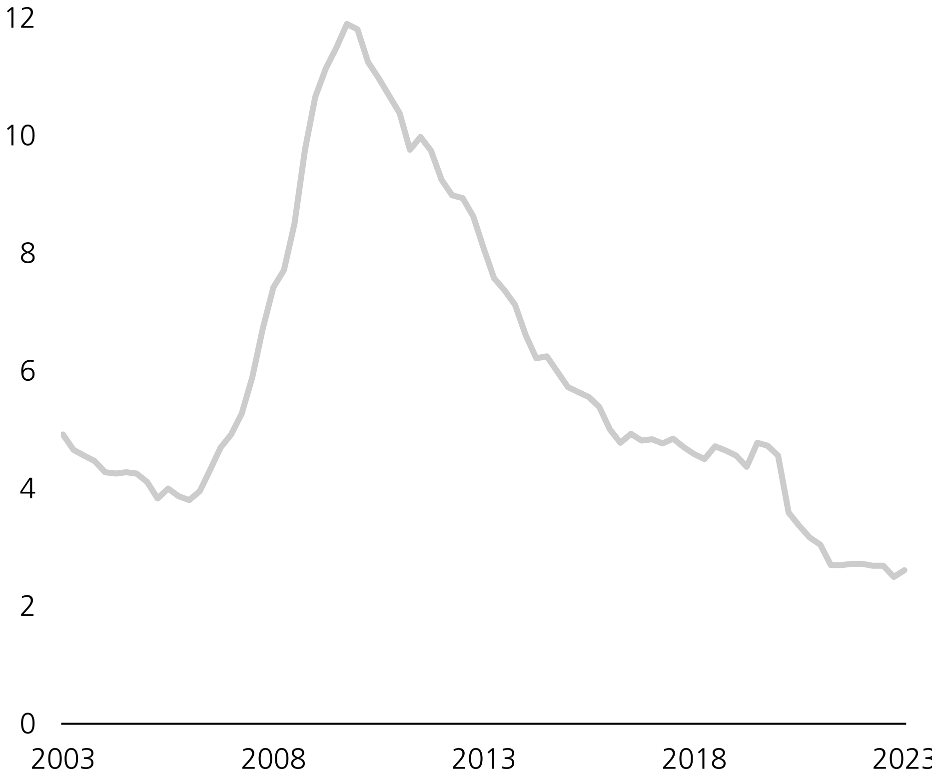
There are pockets of consumer stress with rising delinquency rates for credit cards, but the delinquency rate on all debt is close to 20-year lows.

Millennials' credit card delinquency rate rising fastest
Credit card delinquencies by age, %



Source: Bloomberg, UBS, as of 7 February 2024

Debt delinquency levels remain extremely low
Percent of all US household debt in delinquency

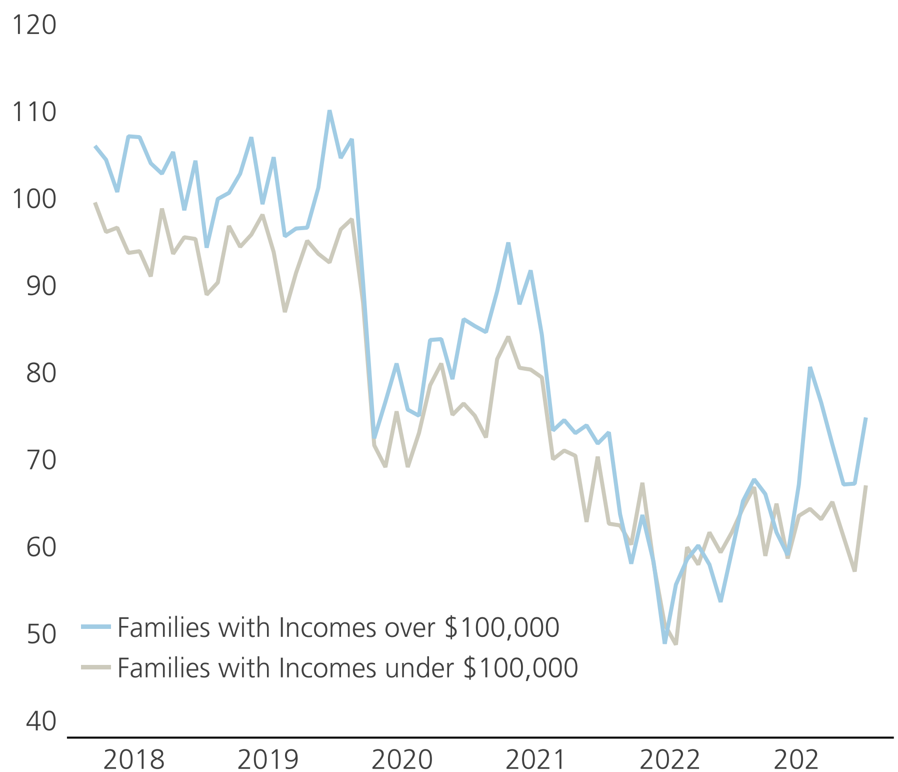


Source: Bloomberg, UBS, as of 7 February 2024

Sentiment: Still low but improving, rising as inflation falls

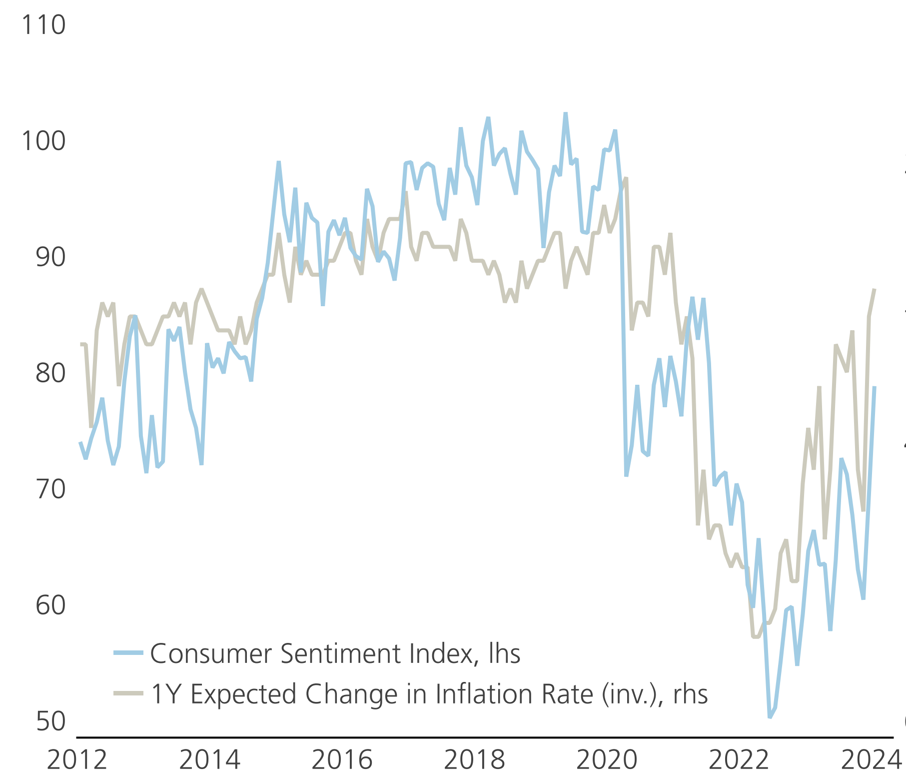
Consumer sentiment is more consistent with recession levels than a robust expansion, but it improving, helped by falling inflation

Rebound in consumer sentiment felt by lower and upper incomes
U. Michigan sentiment index by income



Source: University of Michigan, UBS, as of 7 February 2024

Slower inflation driving better consumer sentiment
Index & %

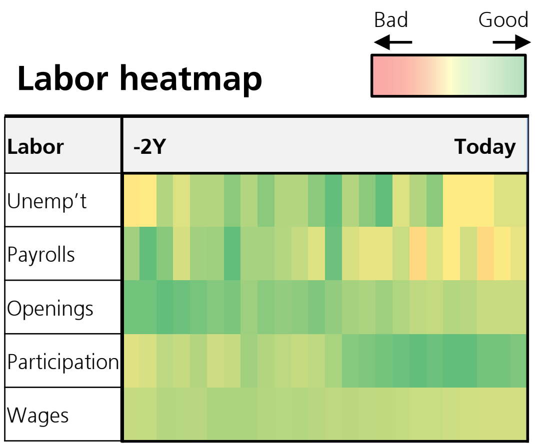


Source: University of Michigan, UBS, as of 7 February 2024

UBS

Labor Key Points: Demand *and* supply cool, wages and AI benefit

Labor heatmap



Note: "Unemployment" is represented by the unemployment rate; "Payrolls" is represented by 1-month change of non-farm payrolls; "Openings" is represented by share of job openings relative to employment; "Participation" is represented level of prime age (25-55) labor force participation; "Wages" is represented by the average of the yearly change in hourly earnings, employment cost index, and Atlanta Fed median wage tracker
Source: Bloomberg, BLS, Federal Reserve, UBS, as of 7 February 2024

Demand is slowing, but labor hoarding is real. Aggregate job openings are down ~30% since post-Covid peak. Hiring remains robust, but slower than the post-pandemic scramble.

Labor supply is tight and the composition is changing. The prime-age (25-54) labor force participation rate is at its highest point in decades as Gen Z workers start to outnumber Boomers.

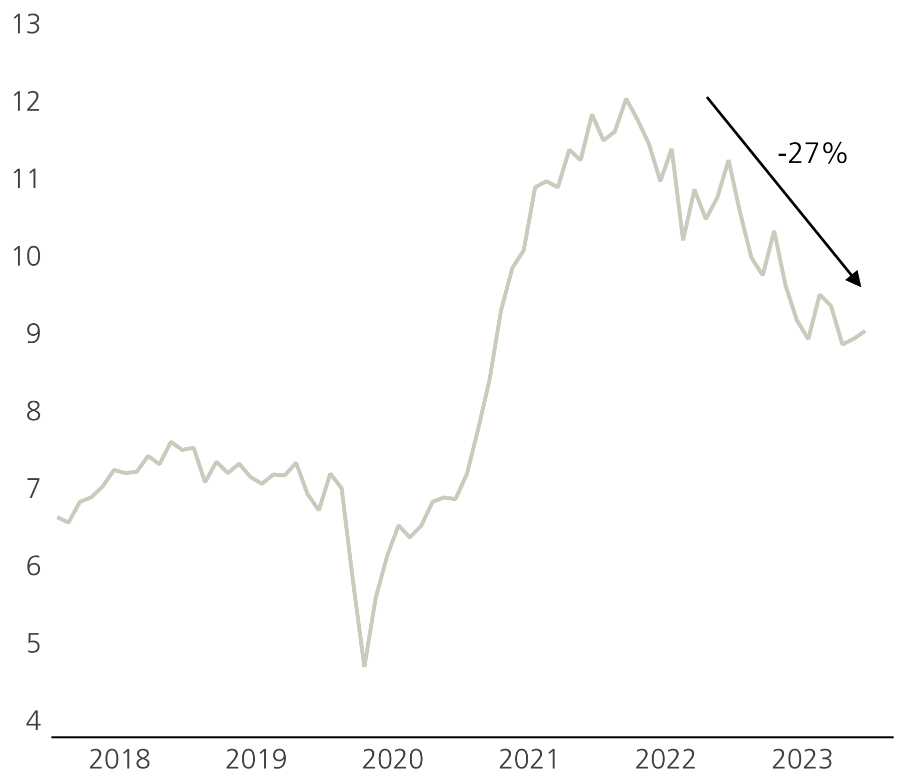
Nominal wage gains are cooling, but rising in real terms. Average hourly earnings are rising nearly 5%, down from almost 7% in 2022. But after inflation, real wage growth is now positive and could be 1-2% in 2024.

Productivity growth and capital substitution. Labor shortages are forcing businesses to investment more in technology as a substitute. The impact from deploying artificial intelligence (AI) has been minimal so far, but likely to be increasingly large later this decade.

Labor Demand: It's cooling, but with large sector differentiation

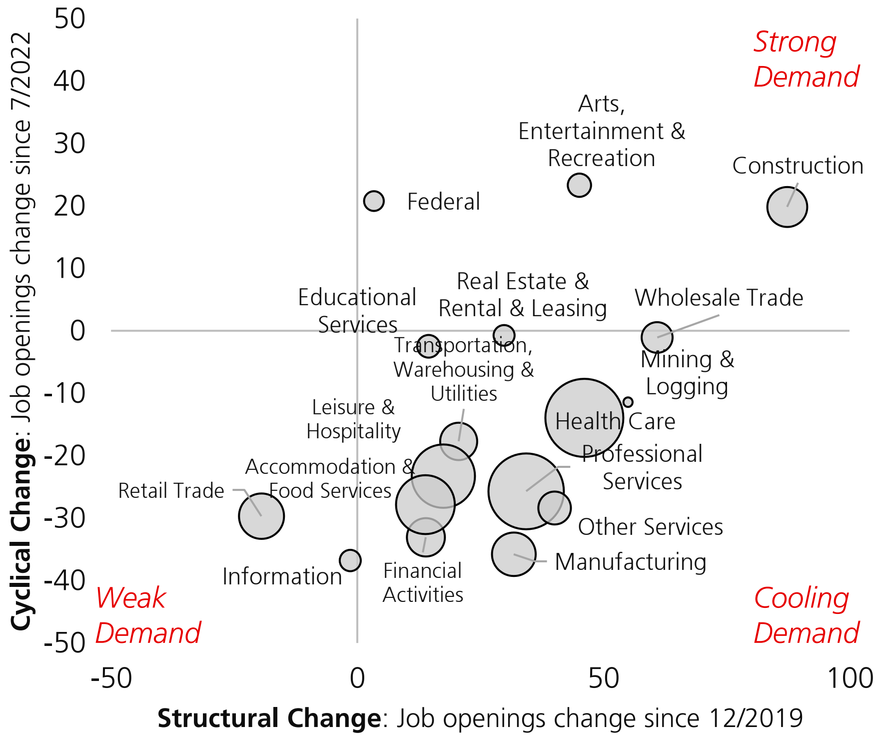
While overall job openings are down ~30% from their 2022 peak, the federal government, recreation services, and construction still have very strong labor demand.

Job vacancies down nearly 30% since peaking in 2022…
in mil.



Source: BLS, UBS, as of 7 February 2024

…with a differentiated effect on a sector basis
Job openings, % difference (Circle relative to sector size)



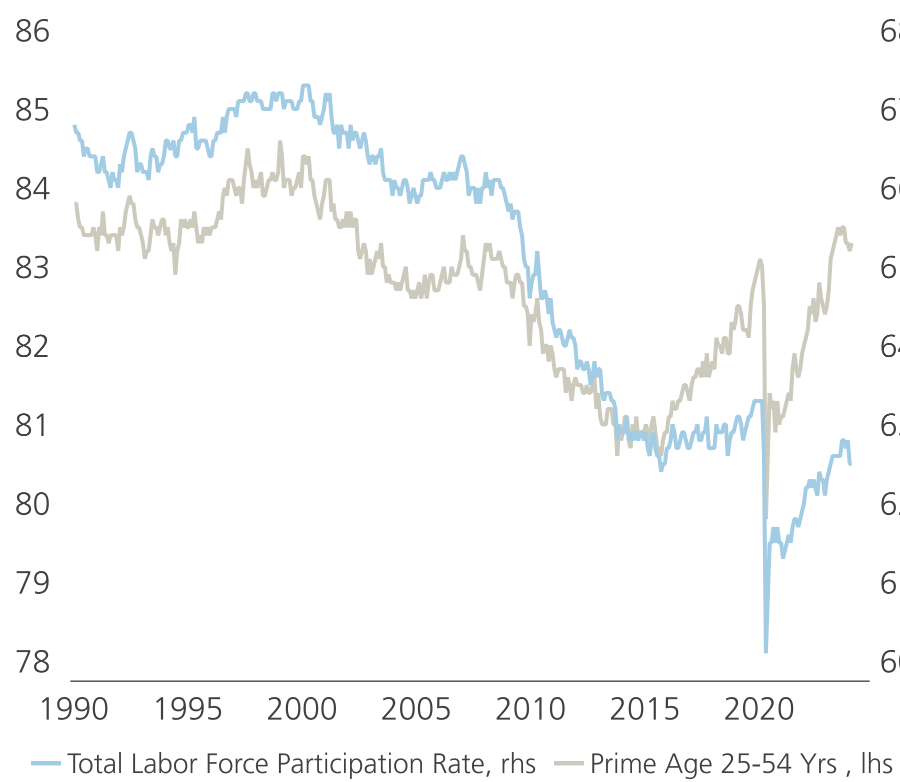
Source: BLS, UBS, as of 7 February 2024

UBS

Labor Supply: Very tight for prime-age (25-54) workers

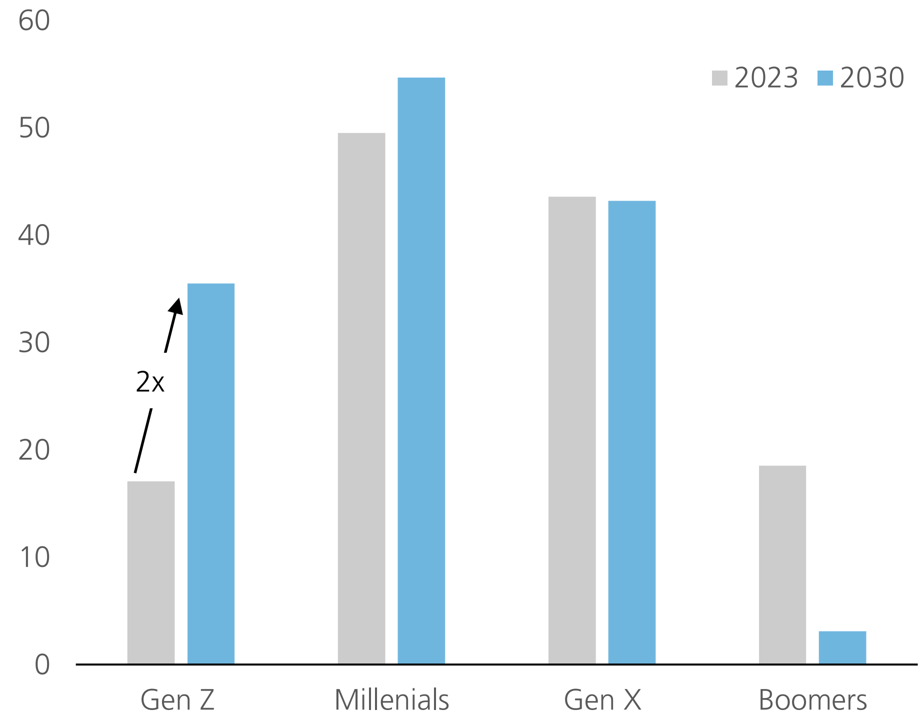
Prime-age labor force participation is already higher than pre-pandemic levels; by 2030, 17 million more Zoomers are expected to enter the workforce, while Boomers largely exit.

Prime age (25-54) Labor Force Participation rate
%



Source: BLS, UBS, as of 7 February 2024

Labor Force separated by generation
in millions of persons



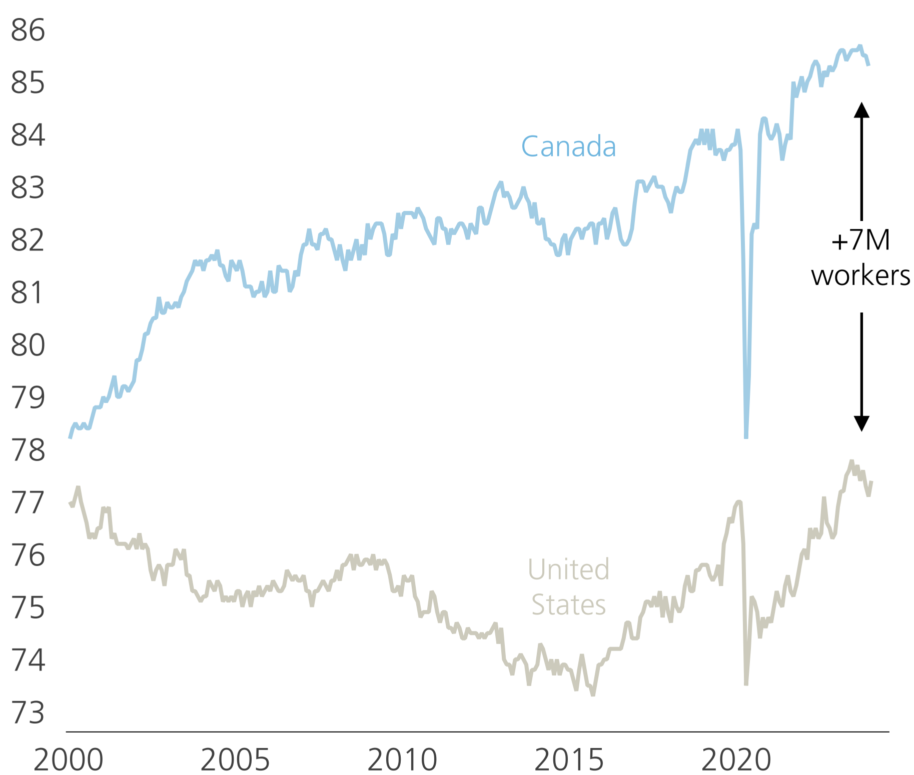
Source: BLS, UBS, as of 7 February 2024

UBS

Labor Supply: Women are benefiting from post-pandemic recovery

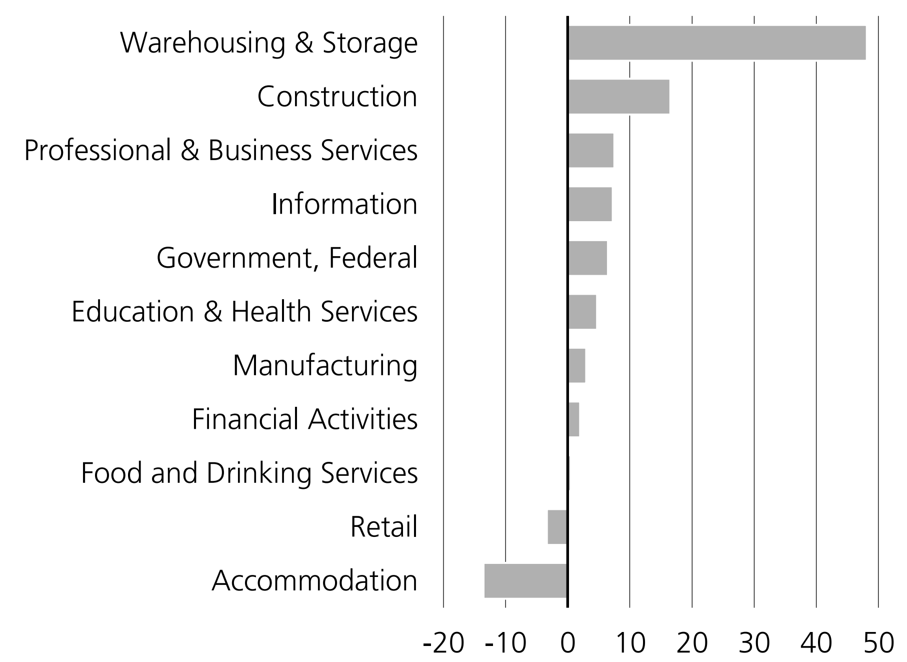
If the US had the same female participation rate as Canada, it would add 7m women to the workforce; female employment is growing fastest in traditionally male jobs (e.g., warehousing, construction).

U.S. and Canada Prime Age Women Labor Force Participation Rate
%



Source: Statistics Canada, BLS, UBS, as of 7 February 2024

Women employment by sector
% difference from 12/31/2019

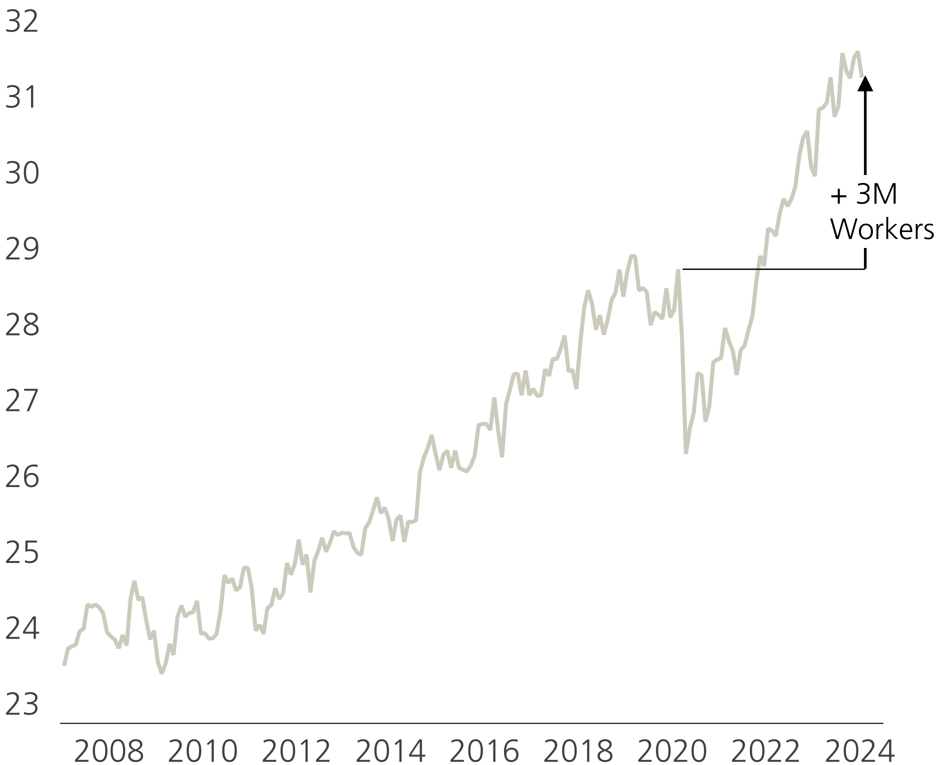


Source: BLS, UBS, as of 7 February 2024

Labor Supply: An immigration surge helped fill the labor shortfall

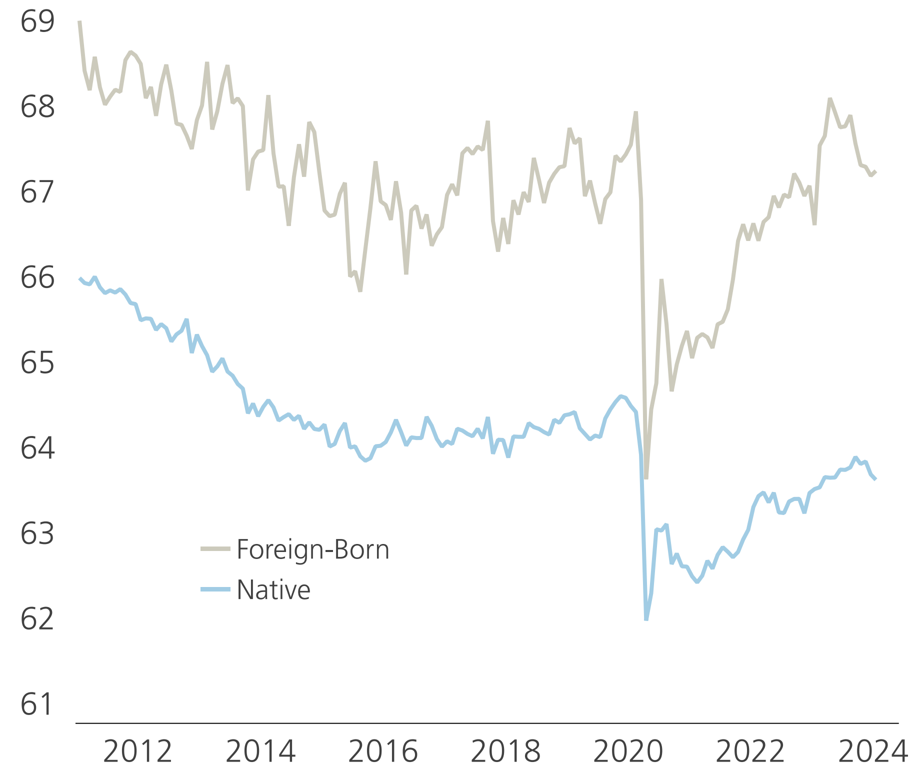
A rapid recovery in legal immigration after the decline in 2020 provided an unexpected boost to labor supply the past two years, but that surge is unsustainable, which could add to labor market tightness.

Foreign born workers are back at the pre-pandemic trend level
in mil.



Source: Census Bureau, UBS, as of 7 February 2024

Participation rate is higher for foreign born workers than native's
%

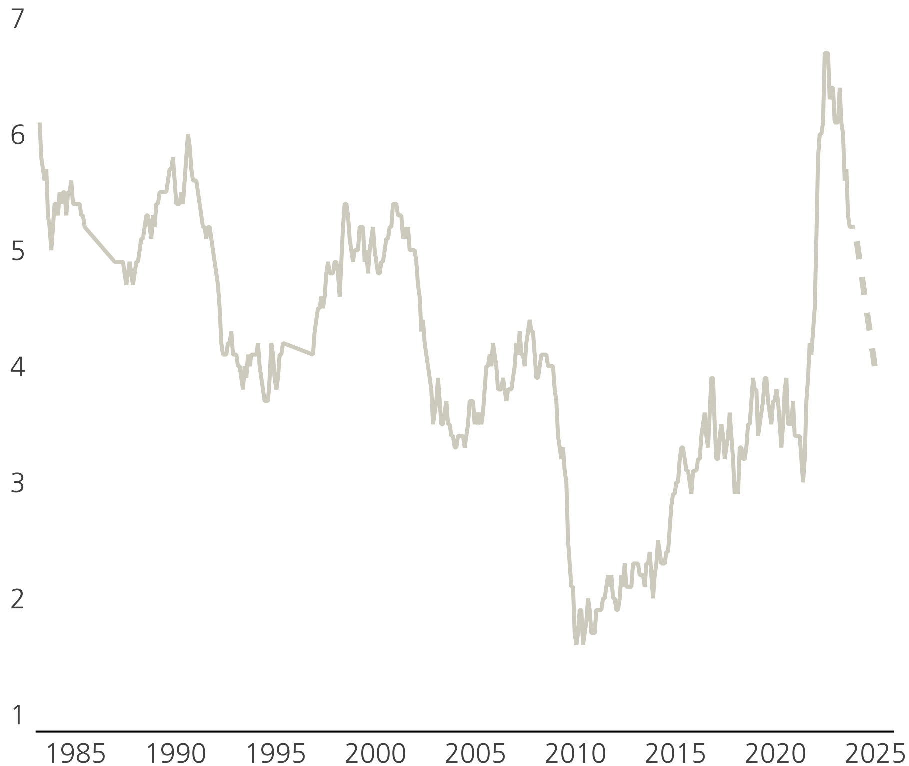


Source: BLS, UBS, as of 7 February 2024

Wages: Overall cooling but still too high for the Fed

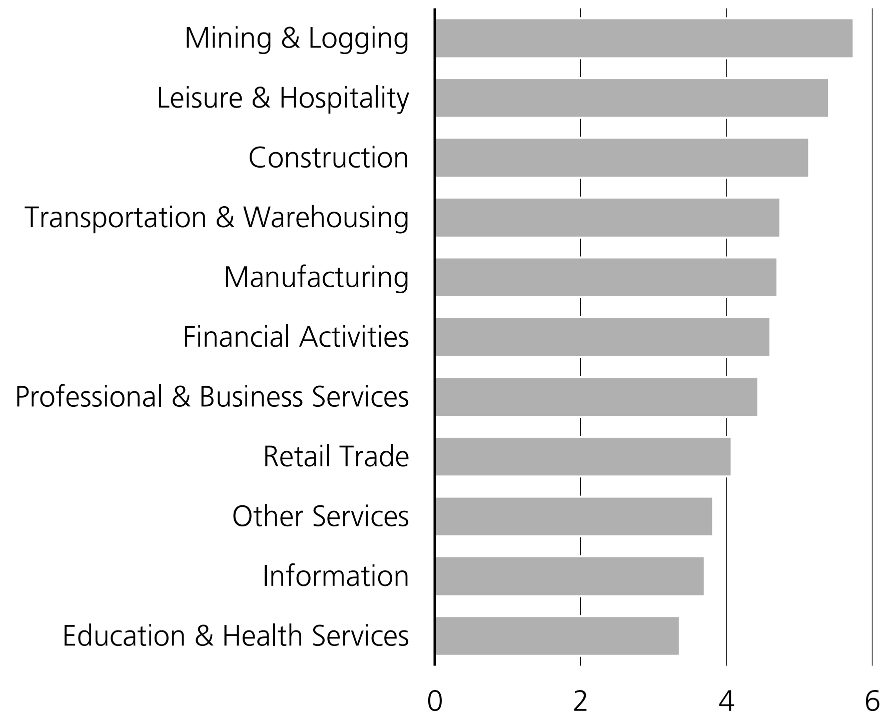
Employers say they expect 4% annual wage increases, but high differentiation across sectors; leisure and hospitality workers are amongst the fastest wage growers compared to other sectors.

Atlanta Fed Median Wage Tracker,
year/year, %



Source: Federal Reserve Bank of Atlanta, WTW, UBS as of 7 February 2024

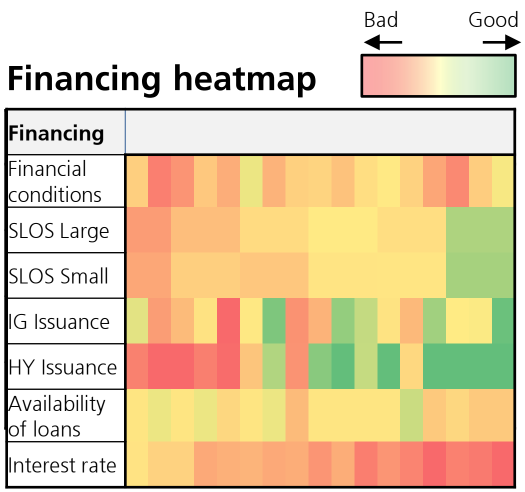
2023 average hourly earnings growth
year/year, %



Source: BLS, UBS as of 7 February 2024

UBS

Financing Key Points: Conditions to ease, but not uniformly for all



Note: Financial conditions refers to the Goldman Sachs Financial Conditions index; SLOS Large & SLOS Mid/Small refers to the quarterly change in standards of Federal Reserve Senior Loan Officer Survey; HY and IG issuance refer to the year/year change in %; Availability of loans and Interest rates refers to components in the NFIB survey
Source: Bloomberg, NFIB, Goldman Sachs, Federal Reserve, UBS, as of 7 February 2024

Financial conditions should continue to loosen in 2024. After bank lending standard continually tightened in 2023, the pace of tightening standards is slowing as confidence in the soft landing and rate cuts grows. The cost of borrowing should decline this year.

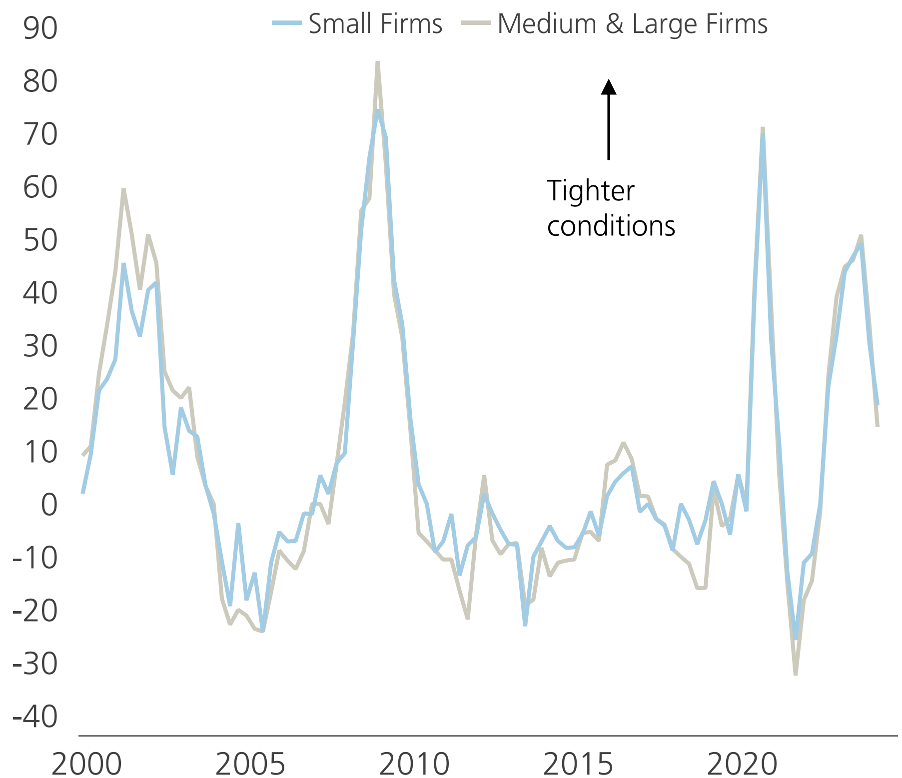
Capital is available for most borrowers, but maybe at a price. Most small business borrowing needs are being met, and all but nearly distressed companies are able to raise capital with bond sales, while spreads are below long-term averages.

Private credit continues to grow. Tight standards have led many firms to consider alternate sources of financing. Private credit AUM has doubled since 2020, with record dry powder currently on the sidelines.

Standards: Tight, especially for small firms, but starting to loosen

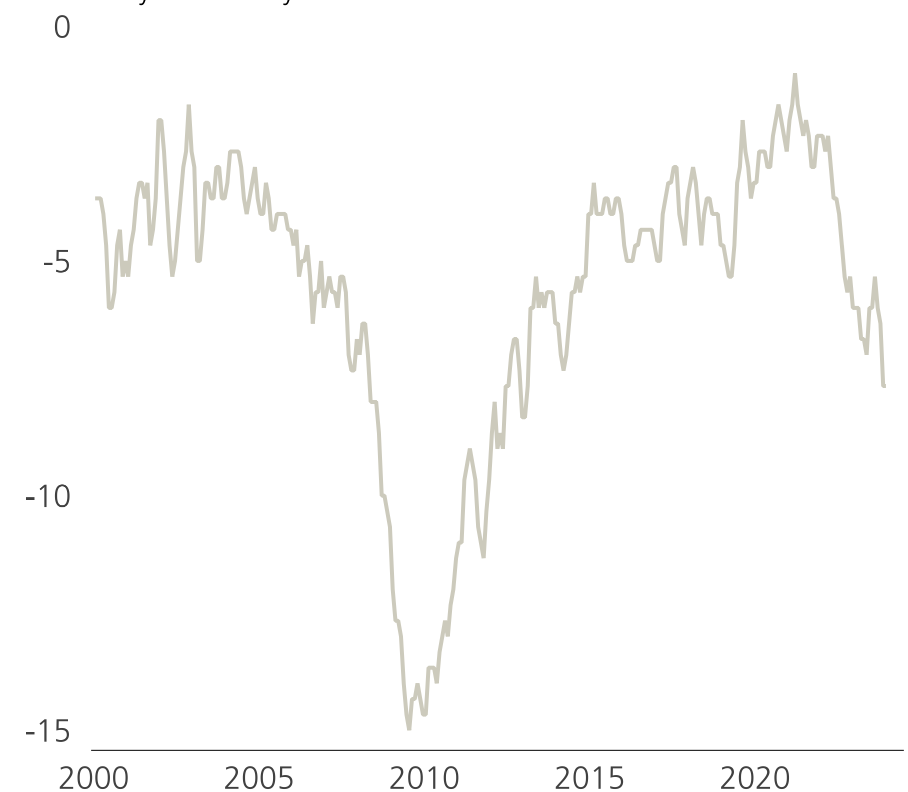
Rate hikes, recession fears, and the regional banking crisis led banks to tighten lending standards for borrowers, but that tightening pace is slowing on rising beliefs in a 'soft landing' and lower rates.

Banks are still tightening standards for loans, but not as much
Senior Loan Officer Survey, tighter standards %



Source: Bloomberg, UBS, as of 7 February 2024

Small firms are still saying loans are hard to get
NFIB survey: availability of loans index

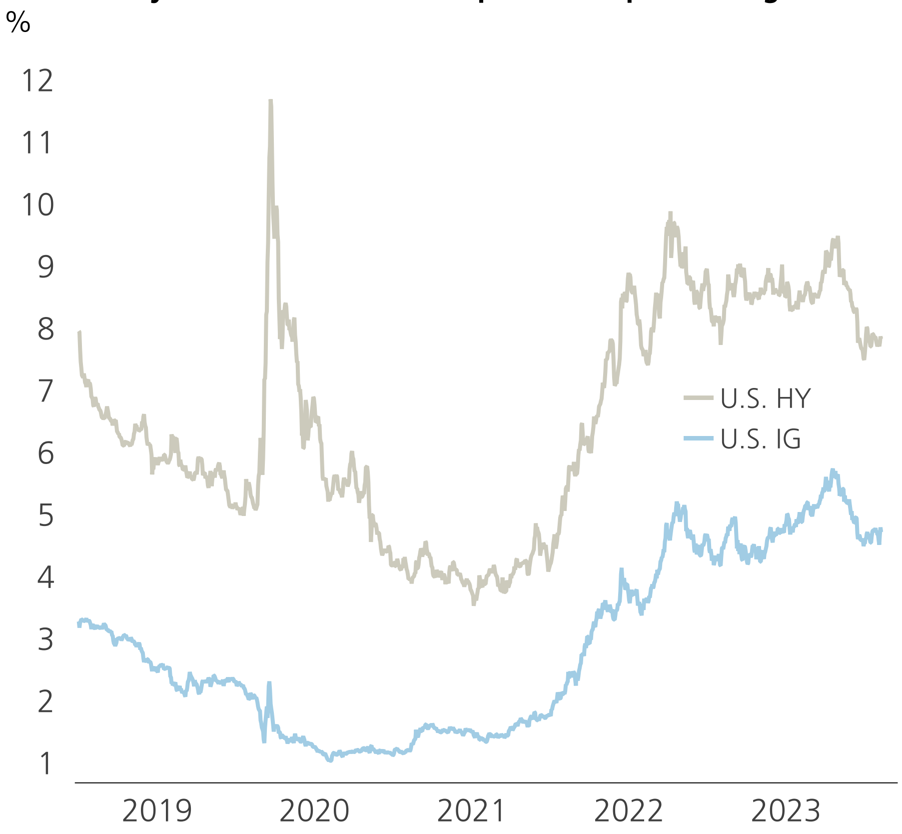


Source: Bloomberg, UBS, as of 7 February 2024

Cost: Borrowing costs should start to fall for smaller firms

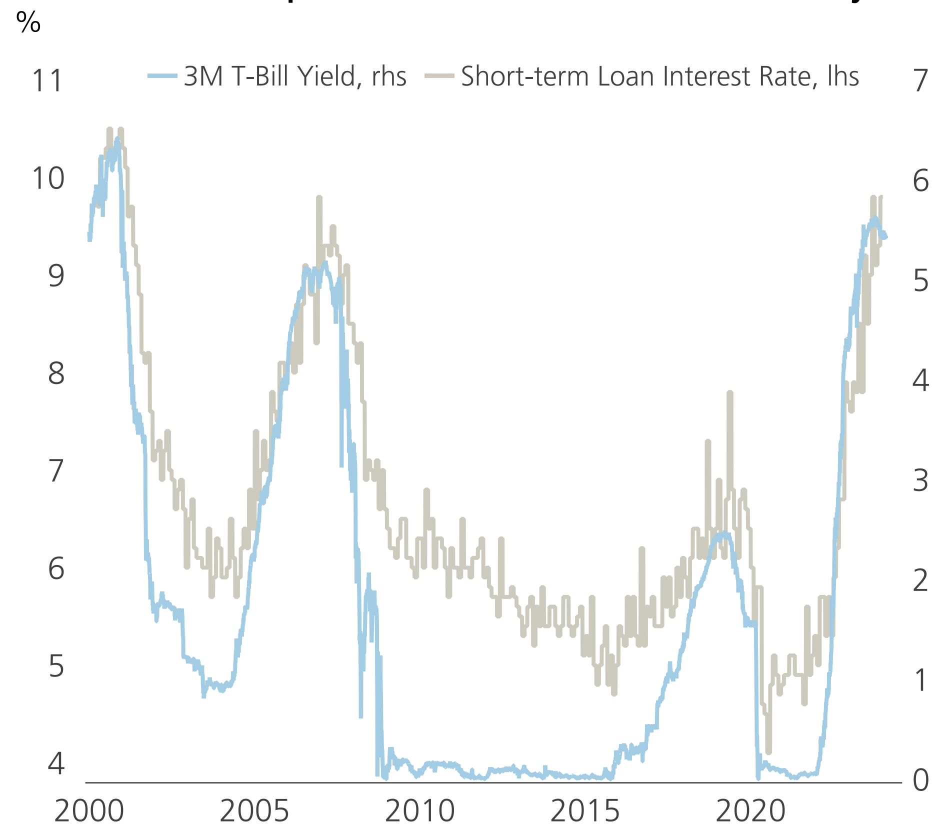
Yields and spreads are lower for public debt issuers, and they should fall for bank borrowers once the Fed starts cutting rates, up to 1 percentage point in 2024.

IG and HY yields are well off their peaks and poised to go lower



Source: Bloomberg, UBS, as of 7 February 2024

Actual interest rate paid on short-term loans tracks 3m T-bill yield

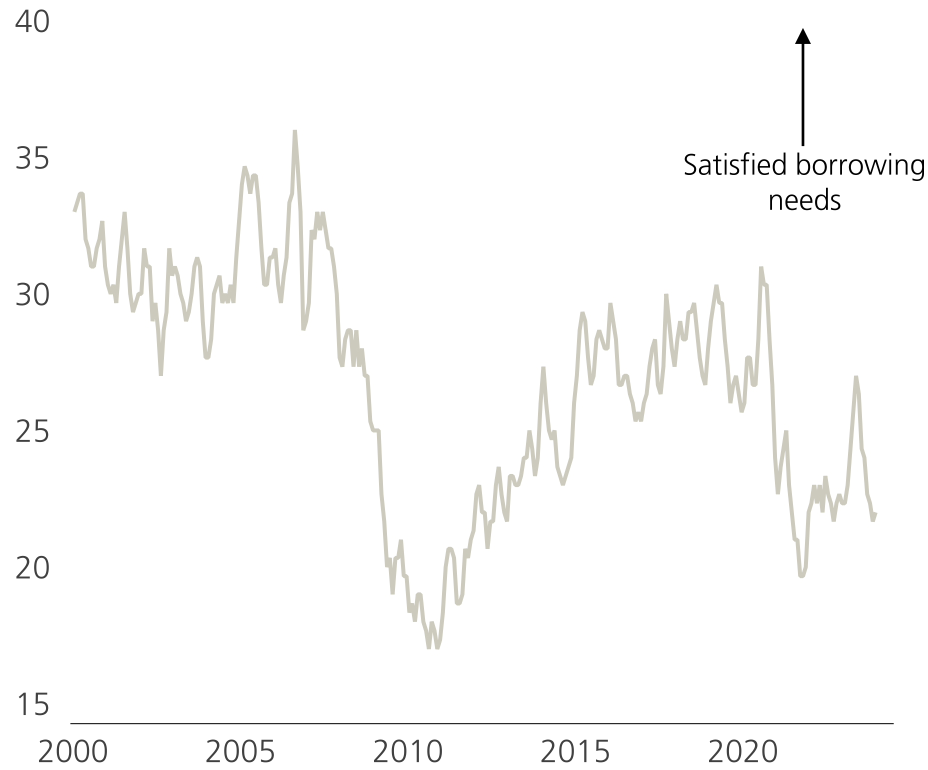


Source: Bloomberg, UBS, as of 7 February 2024

Availability: Capital is available for quality borrowers, at a cost

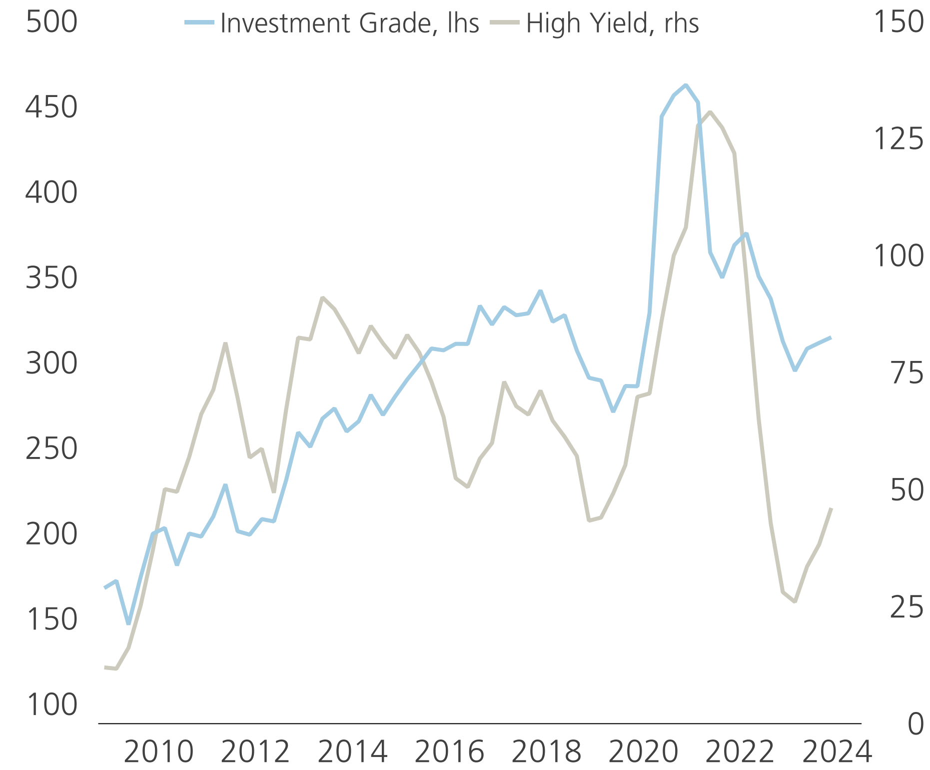
Smaller firms' borrowing needs are generally being met, although it may cost them. Plus, investors are putting money, and there is a lot of it, to work in corporate credit.

Most small business borrowing needs are being satisfied
NFIB survey: 3M MA, net % satisfied



Source: NFIB, UBS, as of 7 February 2024

Bond issuance slowed dramatically last year, is picking up now
1Y MA, $B

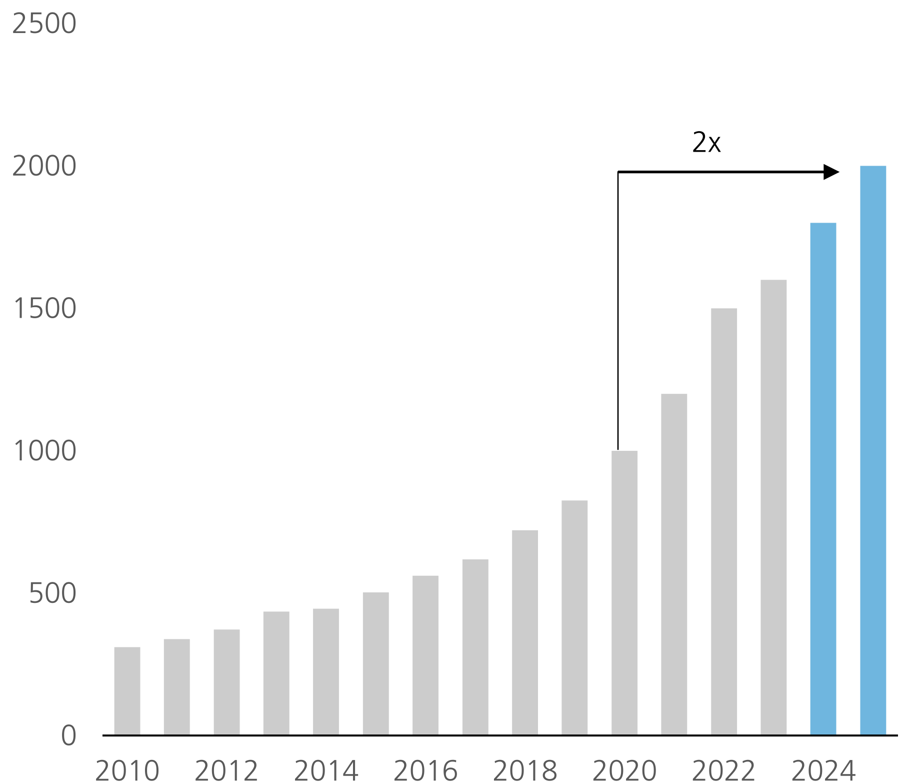


Source: NFIB, UBS, as of 7 February 2024

Private Credit: A growing substitute for bank lending and bonds

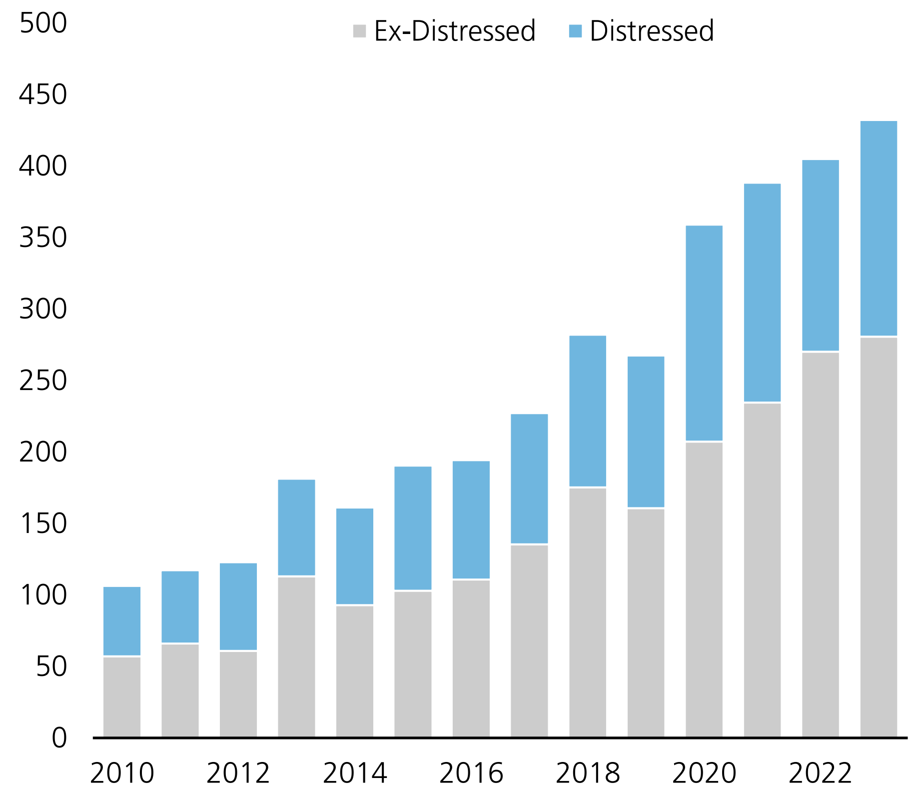
Dry powder for private credit lenders exceeds USD 400bn, USD 150bn of which is earmarked for distressed debt, and that could provide a much-needed lifeline for select firms.

Private Credit AUM has expected to double by 2025
AUM, $B



Source: Preqin, UBS as of 7 February 2024

Private Credit Cry Powder
$ bn

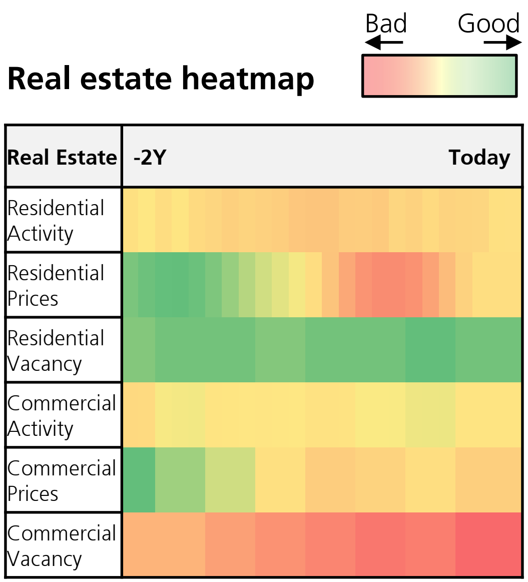


Source: Blackstone, UBS as of 7 February 2024

UBS

Real Estate Key Points: Green shoots, but a long road to recovery

Real estate heatmap



Note: "Activity" is a normalized average of sales and construction; Source: Bloomberg, BLS, NAHB, Federal Reserve, UBS, as of 7 February 2024

Residential affordability is near the worst in decades. High prices and mortgage rates have priced out many potential buyers, especially first-timers. The pick-up in new home starts is a positive, but existing homeowners with low locked-in rates limits the market.

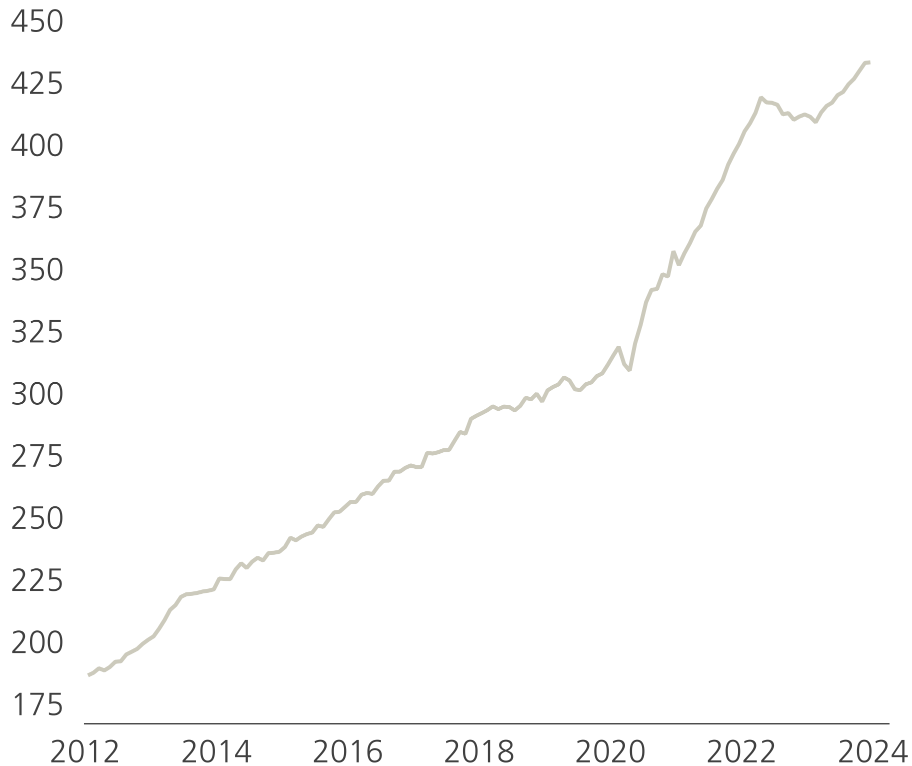
Office is very weak, the rest of commercial real estate (CRE) is okay. Even within office there is a big dispersion between Class A and the rest. But office is only about 15% of the CRE market. There's also significant capital ready to buy distressed assets and debt.

"At risk" geographies facing the highest insurance premiums. Premiums have spiked higher across the board, but especially for those in at-risk climate regions.

Residential: High prices and rates drag affordability to record lows

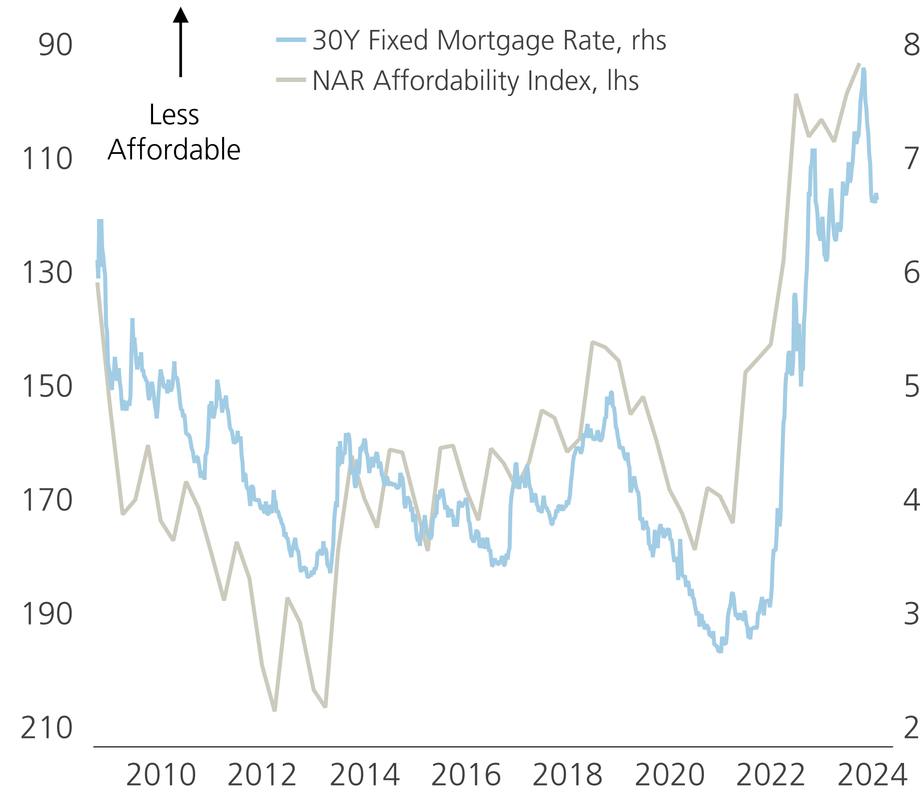
Average 30-year mortgage rates have already come off their highs in anticipation of Fed rate cuts later this year, which should help affordability that remains near the worst in decades.

Median house prices are growing after a few months of contraction
in $ tsds.



Source: BEA, UBS, as of 7 February 2024

Housing affordability is slightly better than its recent all-time low
Index & %



Source: Federal Reserve, UBS, as of 7 February 2024

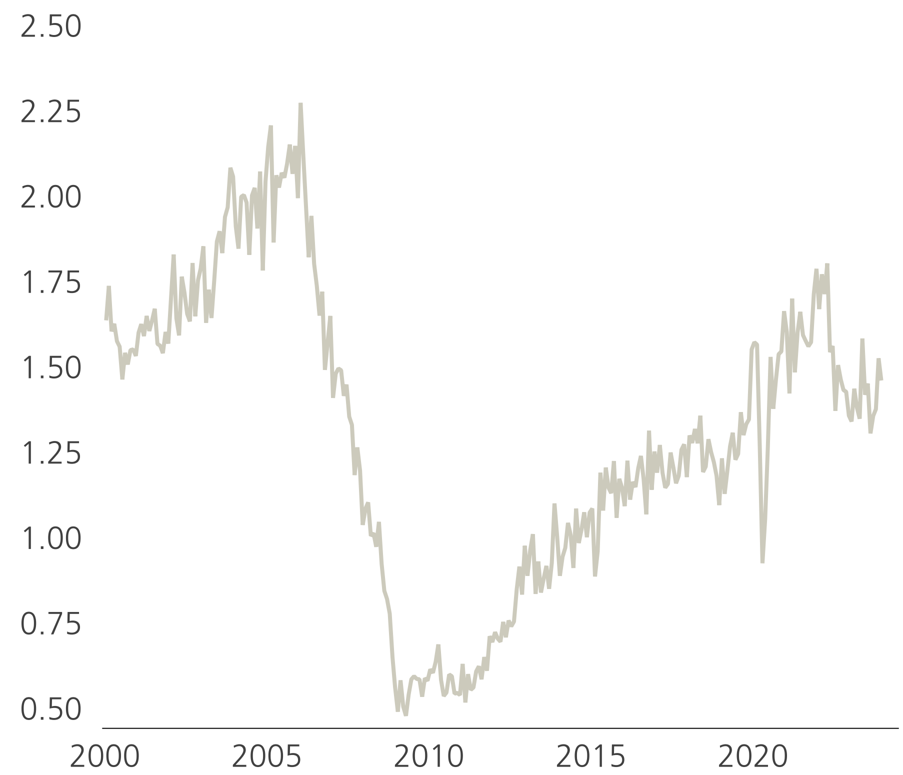
Residential: More home starts barely dent the record-tight inventory

Record low inventory is also a headwind for housing market; new home starts are encouraging, but not nearly enough to offset historic vacancies.

Housing inventory trends at the lowest levels on record
in millions

Source: BEA, UBS, as of 7 February 2024

The pickup in new home starts stalled after the Fed started hiking
in millions



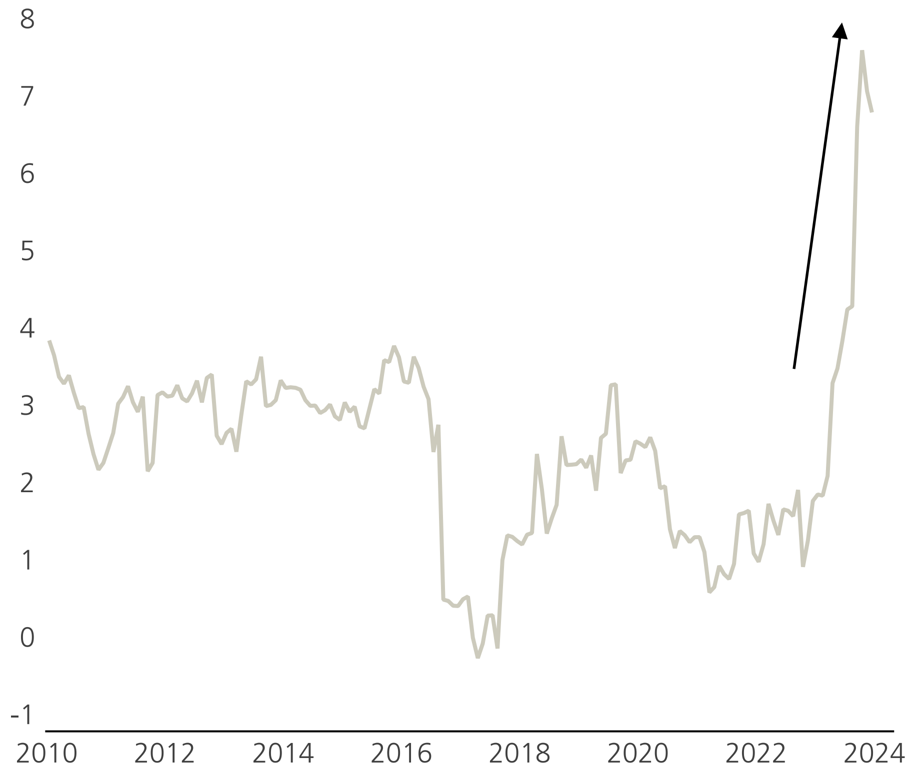
Source: Federal Reserve, UBS, as of 7 February 2024

UBS

Costs: Insurance premiums spiked amid record 2023 heat wave

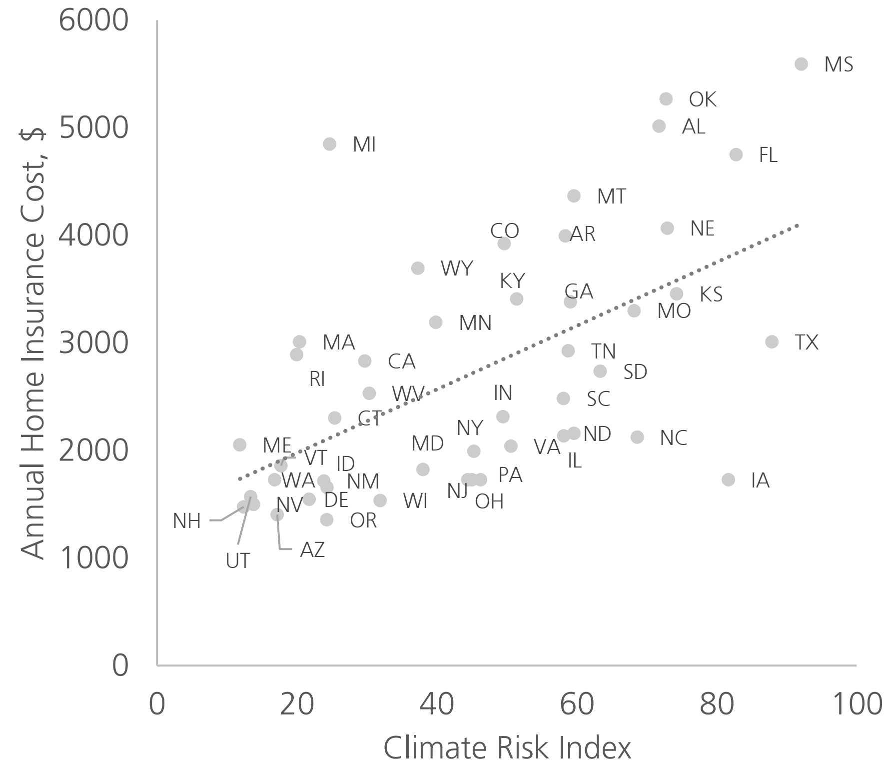
Climate change is a tangible risk that firms and consumers must budget for, especially when it comes to insurance

Insurance premiums spike amidst 2023 global heat wave
y/y %



Source: BEA, UBS, 7 February 2024

With most expensive premiums related to climate risk
Annual home insurance cost, $ and Climate Risk index



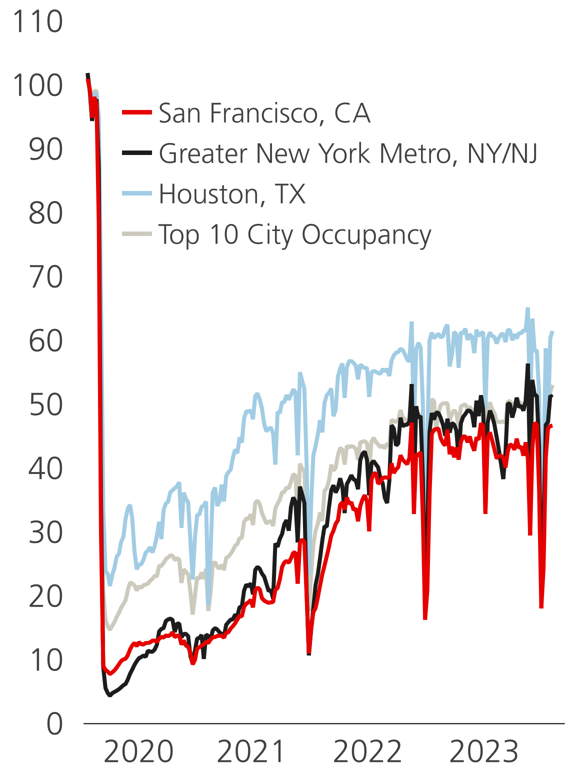
Source: Insurify, OpenWallet, UBS, 7 February 2024

UBS

Commercial: Risks of a meltdown are exaggerated

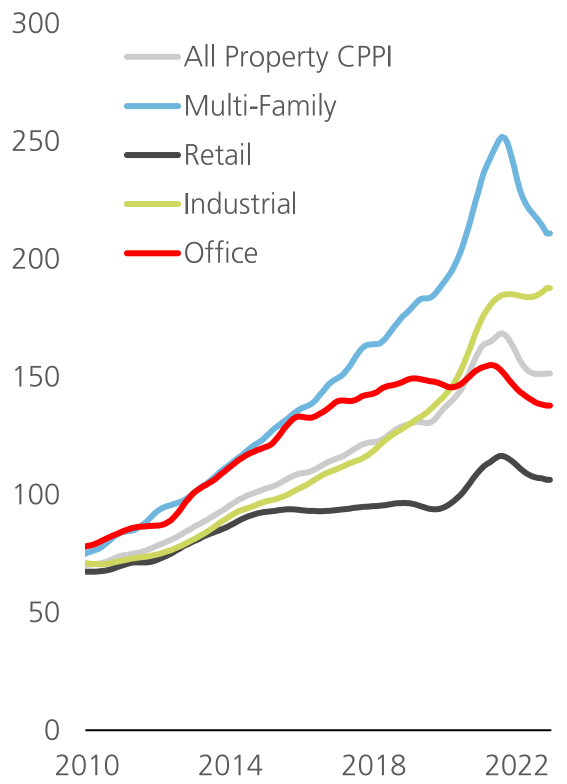
Office properties are seeing stress due to much lower vacancy rates, but this segment of commercial real estate (CRE) occupies less than a fifth of the overall CRE value.

Occupancy level about half pre-pandemic
12/31/2019=100



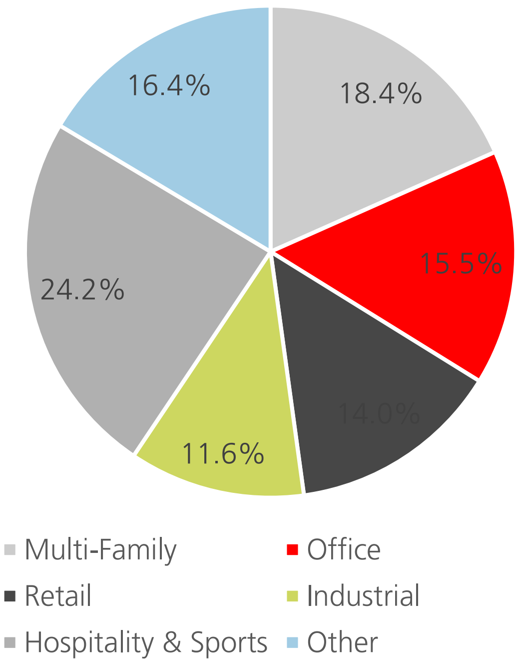
Source: Kastle, UBS, as of 7 February 2024

Moody's Commercial Property Price Index
12/2006=100



Source: MSCI Real Capital Analytics, UBS as of 7 February 2024

Value of office space < 16% total
% Total Commercial Property Value



Source: Nareit, UBS, as of 7 February 2024

Section 4

Politics, geopolitics, and policy

Politics: The US election will be fought over many Issues

No matter who wins the presidency next year, both parties will feel pressure to increase spending programs especially if a recession materializes next year

Voter issues

- Inflation
- Interest rates
- Geopolitical conflicts
- Healthcare

Firm issues

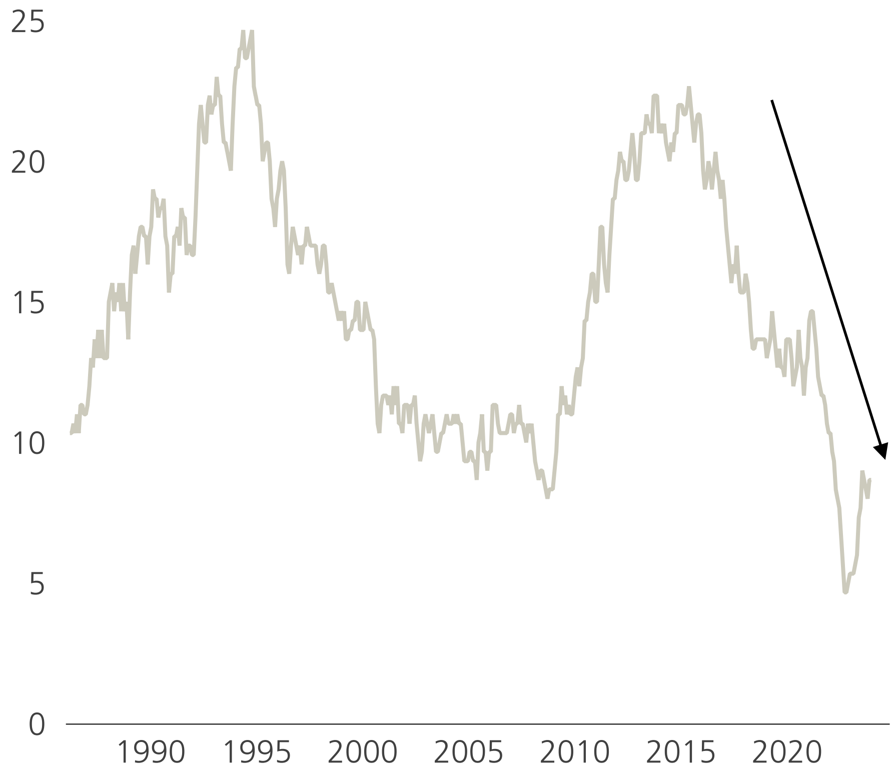
- Climate policy
- Market volatility
- Debt/Fiscal crisis
- Regulation

UBS

Politics: As voters go to the polls in 2024, economy is top of mind

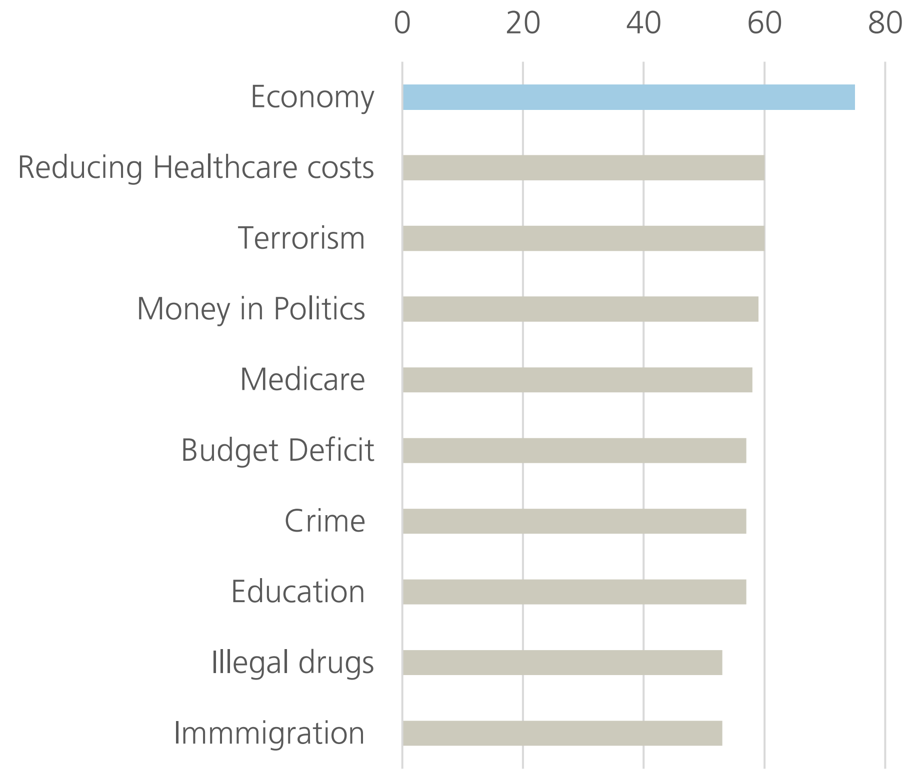
Very few voters view the economy as being in a good place, while regulatory concerns are not a top priority for small businesses.

Firms relatively unconcerned about regulation right now
NFIB Survey: Regulation is single most important problem, %



Source: NFIB, UBS, as of 7 February 2024

Economic issues top of minds for voters going into 2024
% who say ___ is top priority for President and Congress



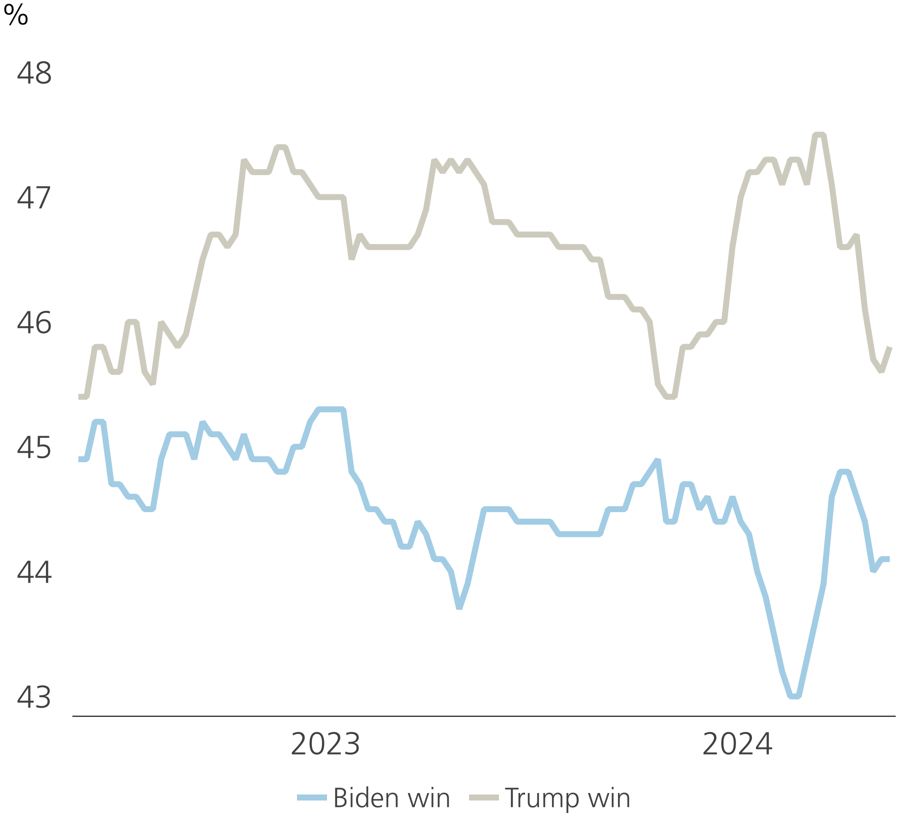
Source: Pew research, UBS, as of 31 October 2023

UBS

Politics: Betting markets foresee a divided government

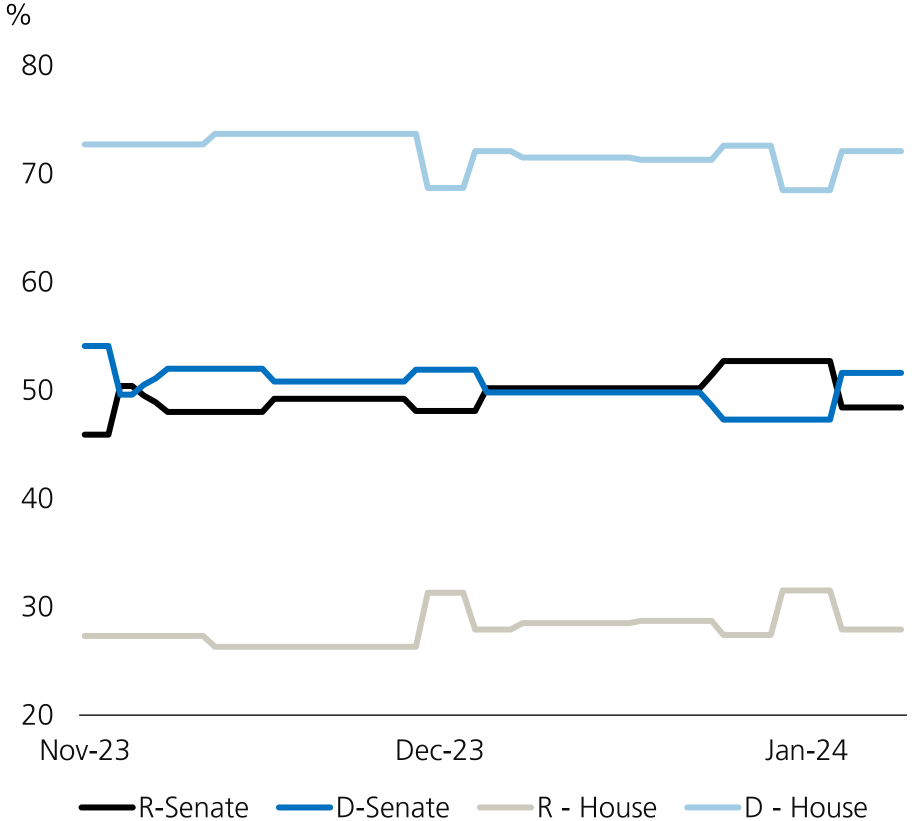
Democrats are favored to gain control of the House, while Republicans are slight favorites set to retake control of the Senate. Divided government will make passing meaningful legislation hard.

In a rematch between Biden and Trump, Trump leads nationally



Source: Real Clear Politics, UBS, as of 7 February 2024

Market Odds on 2024 House / Senate Outcomes



Source: UBS, as of 7 February 2024

Policy: The bias of either potential President is to keep spending

But a divided government and growing concerns on debt levels may limit the scope for fiscal expansion, regardless of whomever is president.

Likely Legislative Stances

	Biden	Trump
Energy	Clean tech to be continued beneficiaries of IRA, more regulation on fossil fuel firms.	Looser EPA regulations, promotion of domestic oil supply.
Trade	Minimal reduction on existing China policies.	Universal 10% tariff and further decoupling from China.
Taxes	More pressure on corporate tax rate and more capital gains taxes.	Extension / renewal of TCJA.
Infrastructure	IRA provisions extended, possibly enhanced.	Some repeal of IRA.

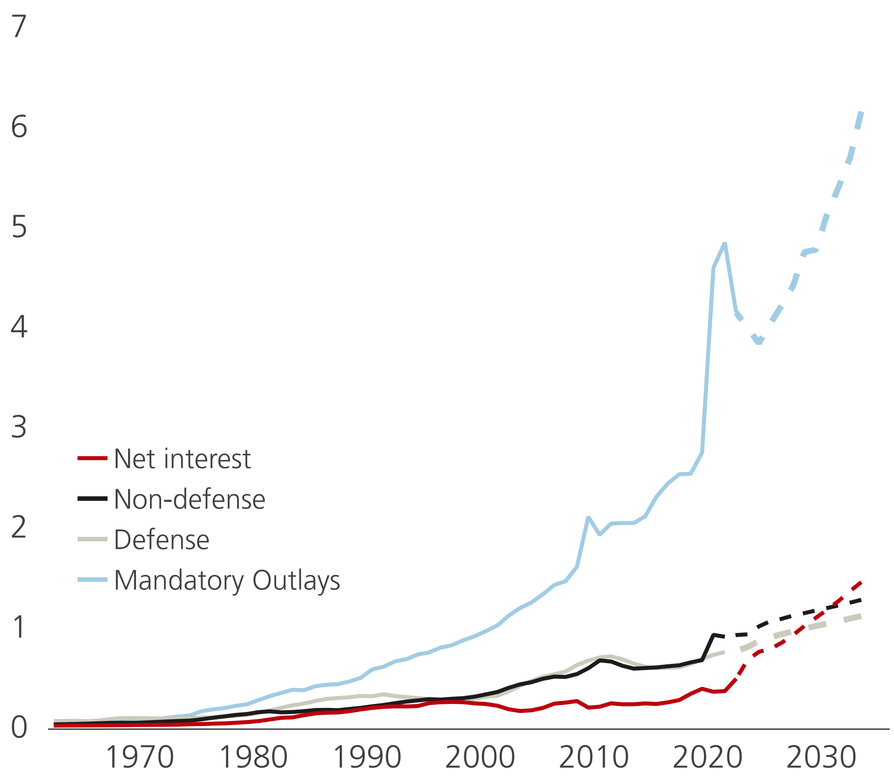
Source: Real Clear Politics, UBS, as of 7 February 2024

Source: UBS, as of 7 February 2024

Fiscal Policy: Growing mandatory spending limits fiscal room

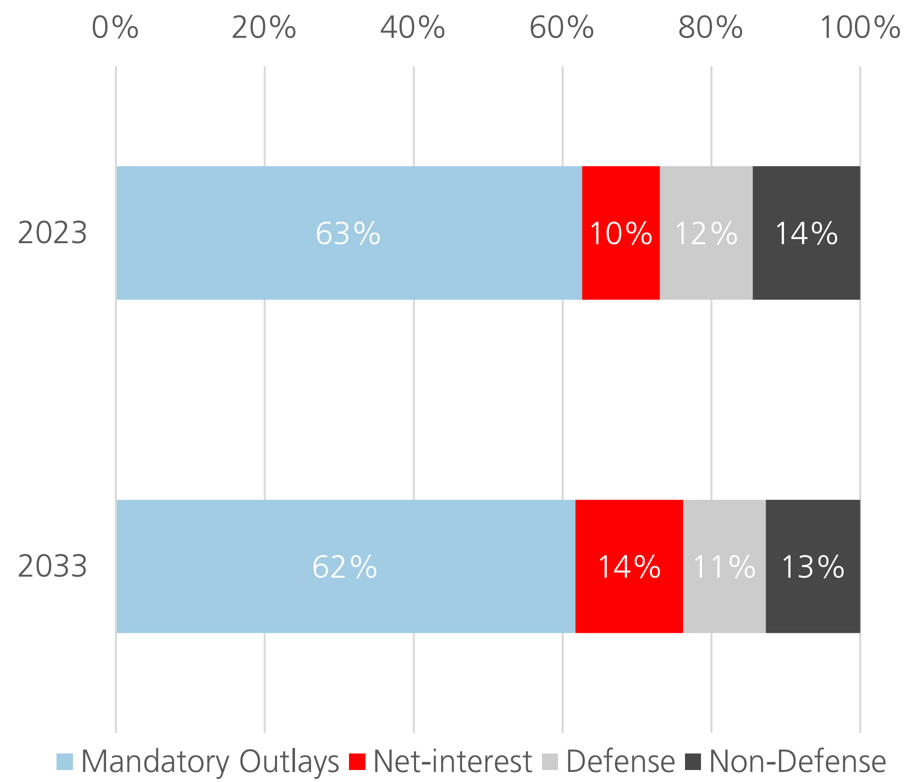
Mandatory spending: Social Security, Medicare etc. Spending will only grow as times goes on while non-defense discretionary spending

Actual and forecast budget expenditures
% GDP



Source: CBO, UBS, as of 7 February 2024

Actual and forecast budget expenditures
% of total



Source: CBO, UBS, as of 7 February 2024

UBS

Section 5

Markets & corporate activity

Market Activity Key Points: Conditions turning favorable for deals

Goldilocks for equities, at least for now... The combination of near trend growth, ongoing disinflation, and pending Fed rate cuts is positive for risk assets. Equity market breadth should improve in this scenario. The S&P 500 P/E is high but not extreme, and ex-Growth, ex-Tech it's closer to long-term averages, and consistent with the macro fundamentals.

...but no "all clear" for deal activity until Fed cuts are imminent. A hot economy that delays rate cuts raises the risk of a policy error and hard landing. This is favoring quality and tech stocks over cyclicals and high beta. The latter includes nonprofitable growth stocks that benefitted from very low rates. Large market swings likely continue until rate cuts start and tail risks decline.

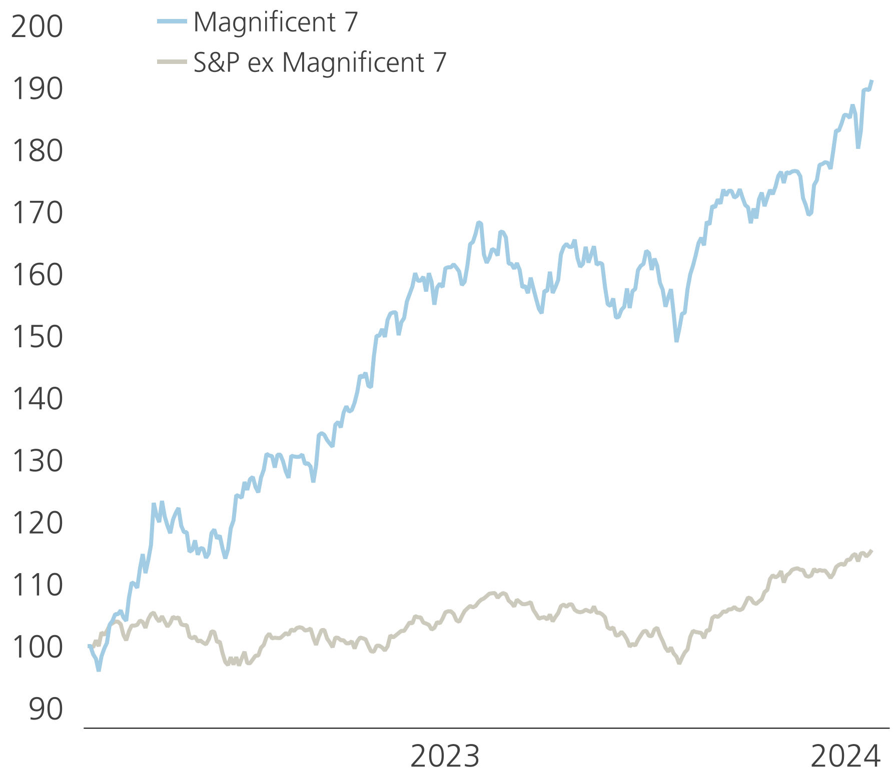
M&A "green shoots" could fully bloom by year-end, if the macro cooperates. Rising equities, low volatility and credit spreads, ample corporate bond issuance, and improving CEO sentiment all support more M&A from a very low base. Strategic acquirers should continue to lead the way as they prepare for a shifting macro and technological environment.

IPO activity and VC funding will likely take more time to warm up. Capital is flowing to AI / ML start-ups in an otherwise soft VC market, while IPO supply is slowly building after two very quiet years. Better performance on new IPOs is necessary to really open the issuance window. The relative bargaining power of VCs and start-ups is getting more in balance, a healthy development.

Equities: The Magnificent 7 are still leading, but more are following

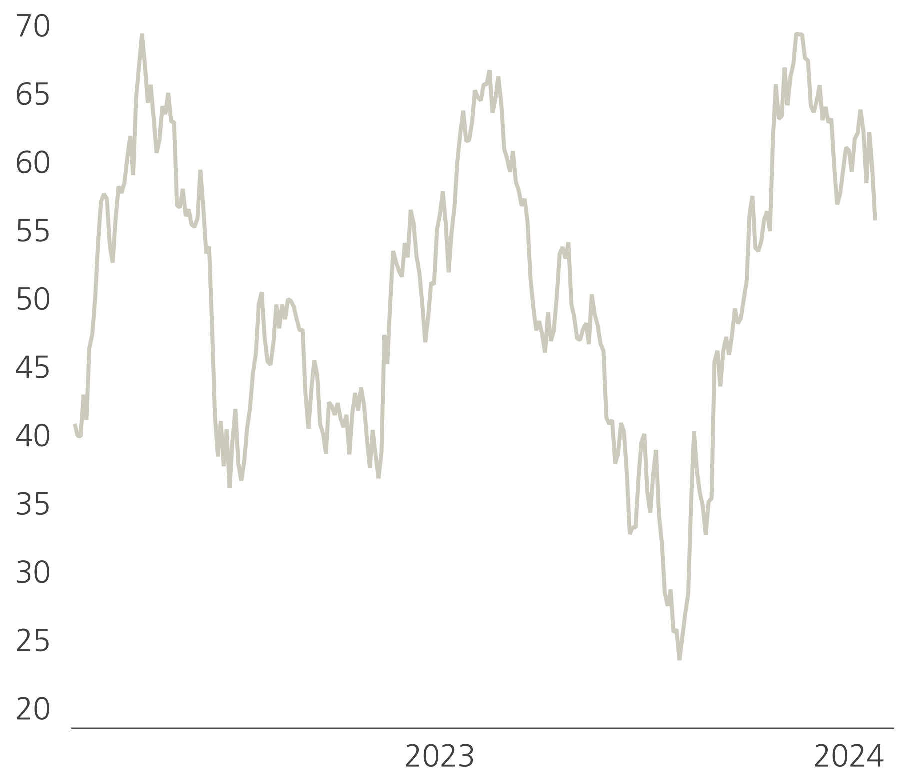
The Magnificent 7 were on their own in 1H23, but the rest of the S&P 500 started performing in Q4, resulting in greater market breadth that's continued in 2024.

Two markets for most of the past year: Mag 7 and everything else
Mag 7 and SPX 493, index=100 as of 1 January 2023



Source: Bloomberg, UBS, as of 7 February 2024

Market breadth rising towards the end of 2023 and into 2024
% of NYSE stocks > 200D moving average



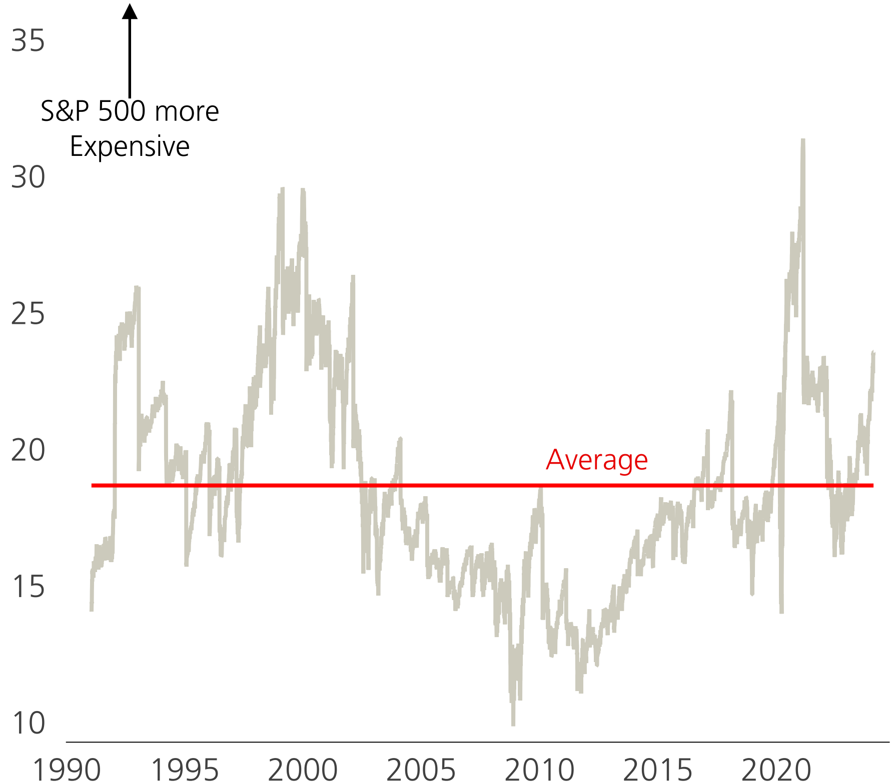
Note: Source: Bloomberg, UBS, as of 7 February 2024

UBS

Equities: The S&P 500 is expensive, but it's not as bad as it looks

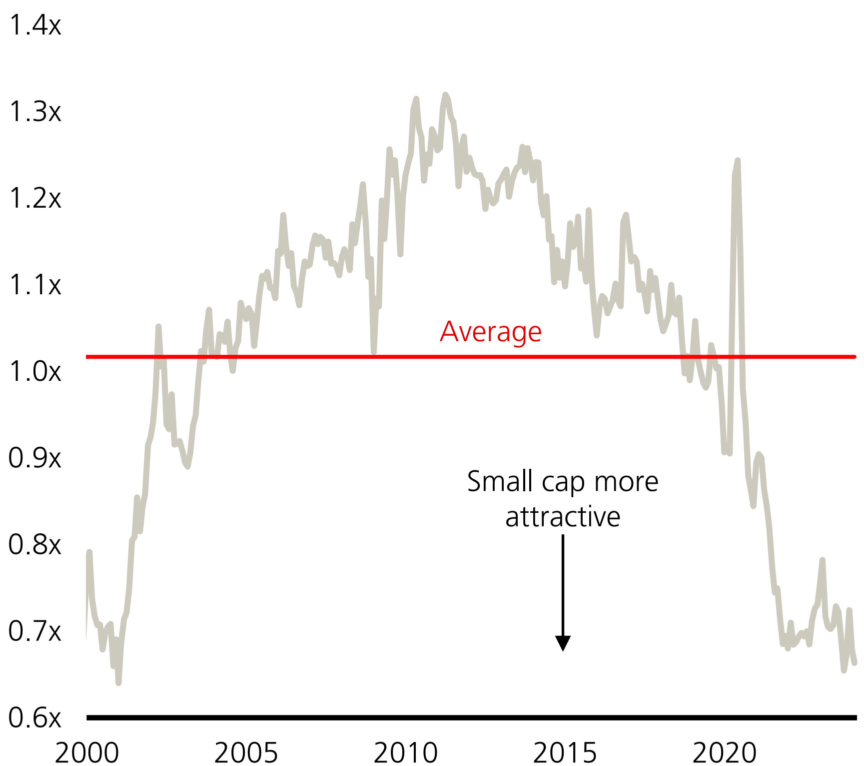
The S&P 500 is rich relative to its own history, but valuations are a poor predictor of market reversals. Plus, valuations outside of large-cap growth and tech are relatively cheap.

S&P 500 P/E is about a standard deviation above its LT average
Forward P/E



Source: Bloomberg, UBS, as of 7 February 2024

Small-cap stocks are very cheap relative to large-caps
Ratio of 12m forward P/E for S&P 600 Small-cap and S&P 500



Source: Bloomberg, UBS, as of 7 February 2024

UBS

Volatility: Big market swings may continue until Fed rate cuts start

Treasury yields and equities swung widely over the past year as the market oscillated between pricing soft and hard landings. This pattern is continuing, but now based on the type of soft-landing.

Huge swings in the 10y Treasury in 2023, only to finish unchanged
10-year Treasury yield, %

Source: Bloomberg, UBS, as of 7 February 2024

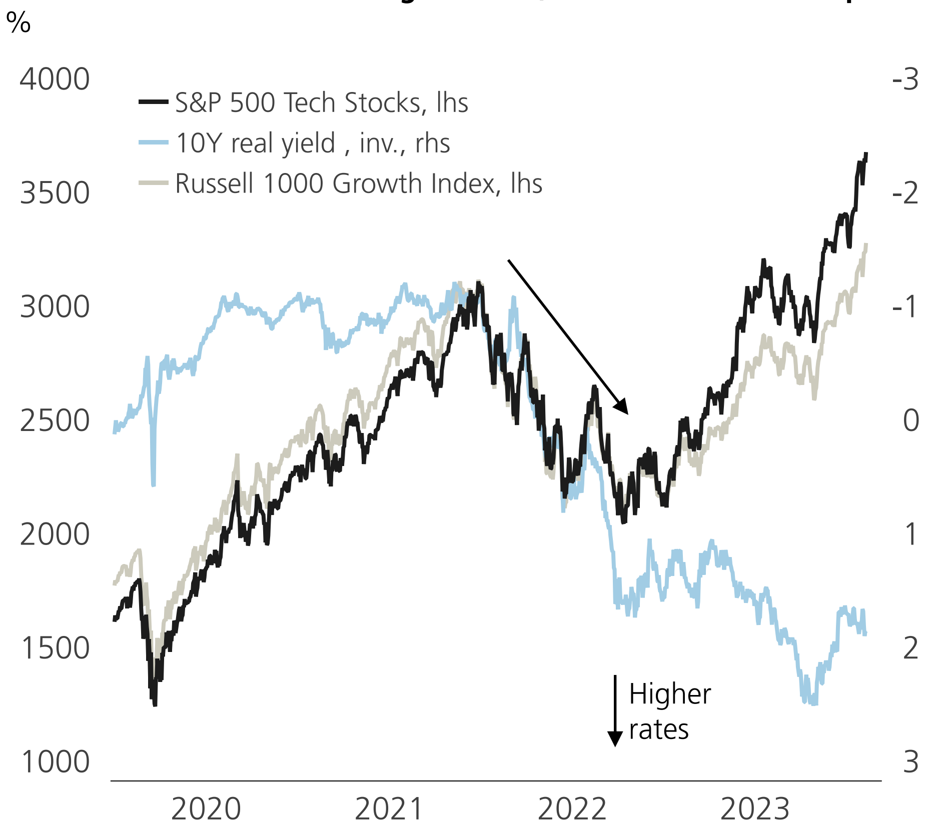
A sustained breakout for the S&P 500 or a new higher range?
S&P 500 Index

Source: Bloomberg, UBS, as of 7 February 2024

Markets: Higher rates are a drag for some equities, but not all

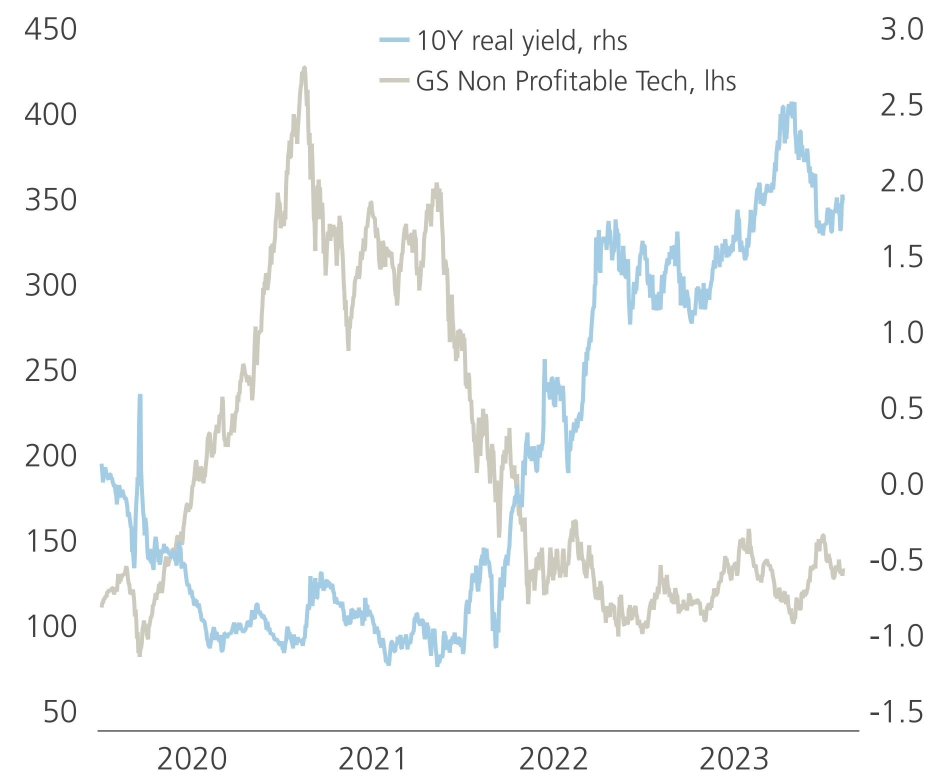
Higher real rates hurt growth stocks in 2021-22, but the impact has persisted only for non-profitable stocks with the longest duration. Lower rates and volatility should benefit speculative stocks the most.

Growth/tech sold off with higher rates, but have since decoupled



Source: Bloomberg, UBS, as of 7 February 2024

Nonprofitable tech is still languishing with higher real rates



Source: Bloomberg, UBS, as of 7 February 2024

M&A: Macro and market conditions are getting ripe for more M&A

Good equity returns, low volatility, improving business confidence, tight credit spreads, an open high yield issuance market, likely lower rates, and easing lending conditions all support an M&A rebound.

M&A Heatmap	**Dec-19**	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**	**Sep-21**	**Dec-21**	**Mar-22**	**Jun-22**	**Sep-22**	**Dec-22**	**Mar-23**	**Jun-23**	**Sep-23**	**Dec-23**
M&A Volume	2%	-13%	-49%	-66%	15%	109%	359%	67%	13%	19%	-23%	-20%	-53%	-40%	-48%	12%	-5%
FCI	98.8	100.4	99.2	98.5	97.5	97.8	97.2	97.4	97.1	97.8	99.7	100.8	100.2	99.7	99.6	100.3	99.3
Vistage CEO Confidence	6.6	7.0	6.5	6.9	6.9	7.1	6.9	6.7	6.5	6.7	5.6	5.9	5.9	6.1	6.6	6.1	6.3
NFIB Small Business Confidence	102.7	96.4	100.6	104.0	95.9	98.2	102.5	99.1	98.9	93.2	89.5	92.1	89.8	90.1	91.0	90.8	91.9
Markets																	
SPX	29%	-9%	5%	13%	16%	54%	39%	28%	27%	14%	-12%	-17%	-19%	-9%	18%	20%	24%
NASDAQ	38%	6%	32%	47%	48%	68%	43%	29%	27%	13%	-21%	-25%	-33%	-11%	32%	34%	54%
Midcap	24%	-24%	-8%	-4%	12%	81%	51%	42%	23%	3%	-16%	-17%	-14%	-7%	16%	14%	14%
Smallcap	24%	-25%	-8%	-1%	18%	93%	60%	46%	14%	-7%	-26%	-24%	-22%	-13%	11%	7%	15%
Rates																	
10Y rate	1.9	0.7	0.7	0.7	0.9	1.7	1.5	1.5	1.5	2.3	3.0	3.8	3.9	3.5	3.8	4.6	3.9
Federal Funds Rate	1.8	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.5	1.8	3.3	4.5	5.0	5.3	5.5	5.5
2s10s Spread	34	42	50	55	79	158	122	121	77	0	5	-45	-56	-56	-106	-48	-37
Financing																	
IG Spread	11	49	21	16	10	4	3	3	8	13	16	15	25	28	18	16	17
HY Spread	338	867	629	521	359	308	267	287	283	321	569	551	468	452	392	395	323
SLOS Large	8.2	-5.4	41.5	29.7	-33.5	-32.2	-20.6	-17.3	14.2	3.7	13.0	25.7	14.9	5.7	1.2	4.8	-16.9
SLOS Mid/Small	11.4	-7.0	41.1	30.3	-38.7	-19.9	-24.3	-12.8	14.6	1.7	9.4	22.2	9.6	12.0	2.9	2.5	-18.8
IG Issuance	148%	120%	121%	4%	64%	-19%	-23%	-3%	76%	19%	-47%	-50%	-84%	-57%	38%	61%	95%
HY Issuance	3300%	-86%	95%	37%	46%	1691%	-34%	2%	-61%	-83%	-71%	-84%	-81%	-57%	38%	212%	445%
Volatility																	
MOVE	58	84	54	39	49	71	57	61	77	107	136	142	122	136	111	114	115
VIX	14	54	30	26	23	19	16	23	17	21	29	32	22	19	14	18	12

Note: SLOOS Large and SLOOS Mid/Small measure the change in tightening standards
Source: Bloomberg, UBS, as of 7 February 2024

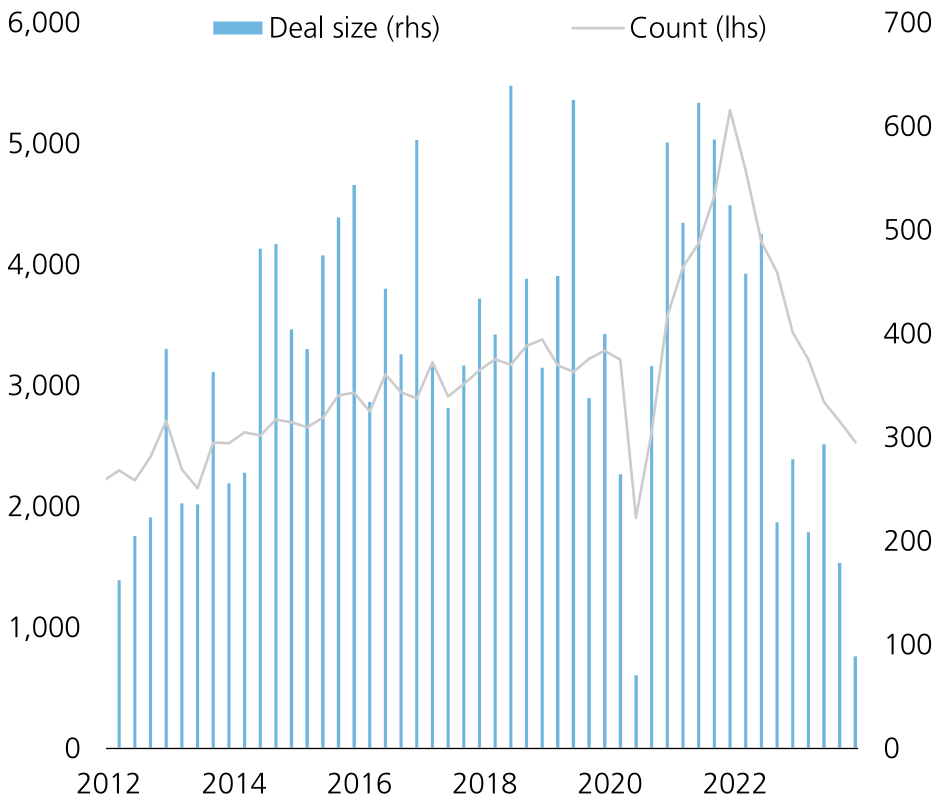
Negative Positive

UBS

M&A: Strategic buyers likely lead the recovery from very low levels

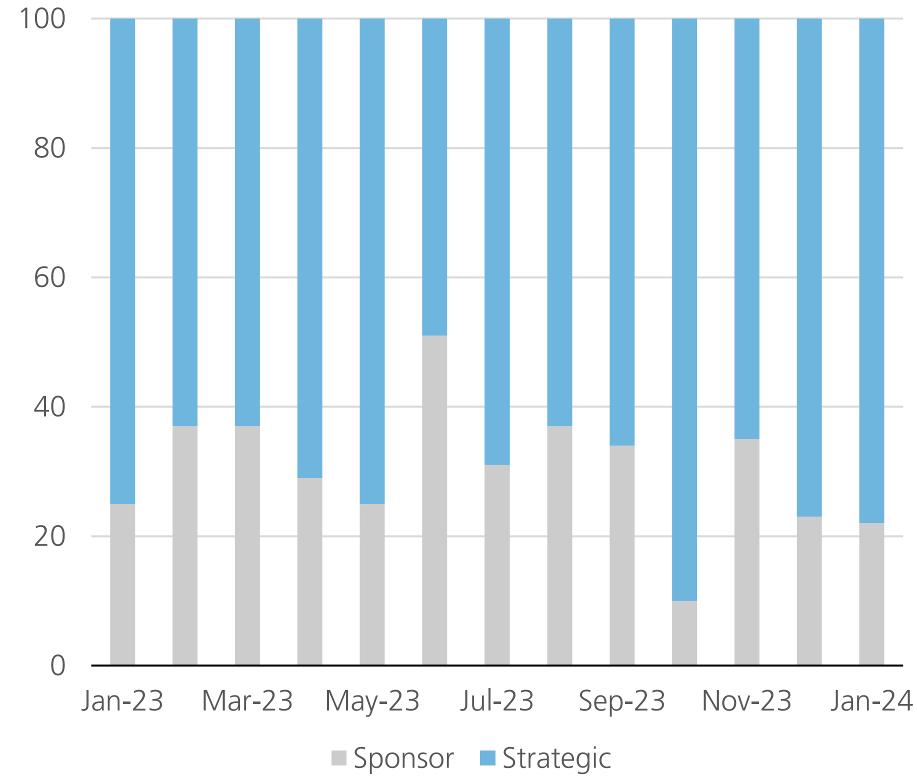
M&A volumes in 2024 could easily double their level over the past two years, and strategic buyers may dominate as they've been on the sidelines waiting for a more favorable environment.

North American M&A activity near decade lows
$B



Source: Bloomberg, UBS, as of 7 February 2024

Recently more strategic buyers relative to sponsors than the avg.
% of total volume



Source: Dealogic, Citi, Bloomberg as of 7 February 2024

M&A: Already 5 deals > USD 5bn announced year-to-date

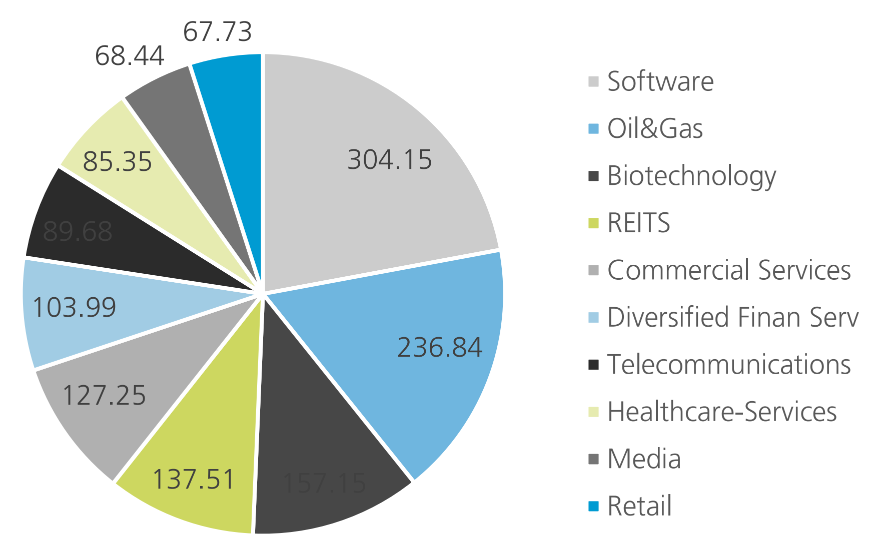
M&A deal announcements in January in North America more than doubled the volume of January 2023, an earlier indication that activity is likely to pick-up quite a bit this year.

Top 10 largest M&A deal announcements so far in 2024

Date	Target Name	Acquirer Name	Value $M
1/5/2024	ANSYS Inc	Synopsys Inc	33,390
1/9/2024	Juniper Networks Inc	Hewlett Packard	13,057
1/12/2024	Global Infra. Management	BlackRock Inc	12,578
1/11/2024	Southwestern Energy Co	Chesapeake Energy Corp	11,597
1/22/2024	NuStar Energy LP	Sunoco LP	6,482
1/4/2024	Callon Petroleum Co	APA Corp	4,454
1/18/2024	MDC Holdings Inc	Sekisui House Ltd	4,409
1/29/2024	McGrath RentCorp	WillScot	3,678
1/25/2024	China Fortune Land Dvlpt.	Creditors	3,346
1/8/2024	Axonics Inc	Boston Scientific Corp	3,255

Source: Bloomberg, UBS, as of 7 February 2024

M&A by Sector in 2023
Top 10 Sectors in 2023 M&A Deals, $B



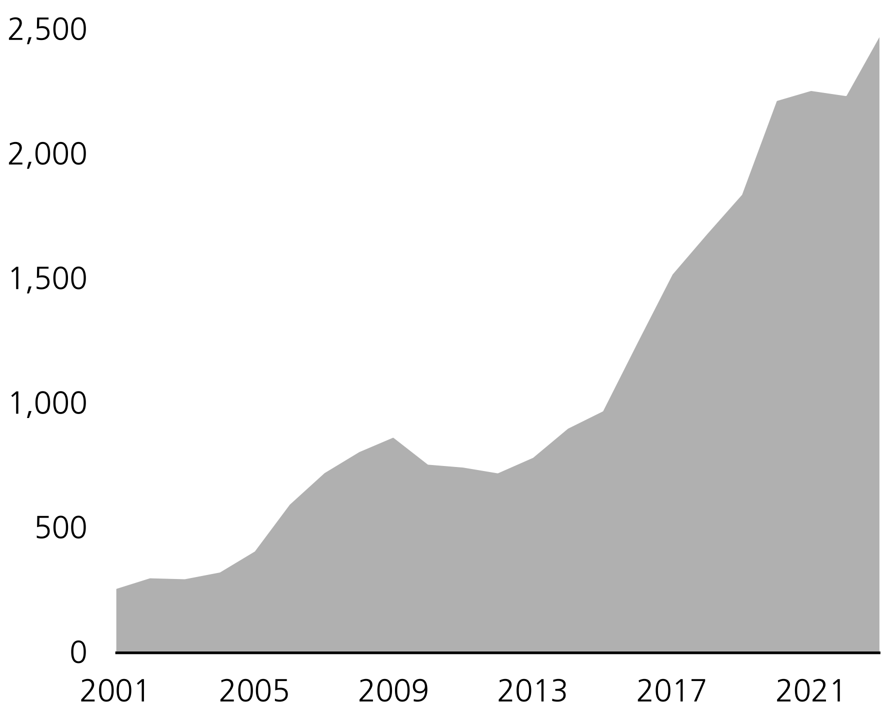
Source: Bloomberg, UBS, as of 7 February 2024

UBS

Private Equity: Dry powder at an all-time high as exits are muted

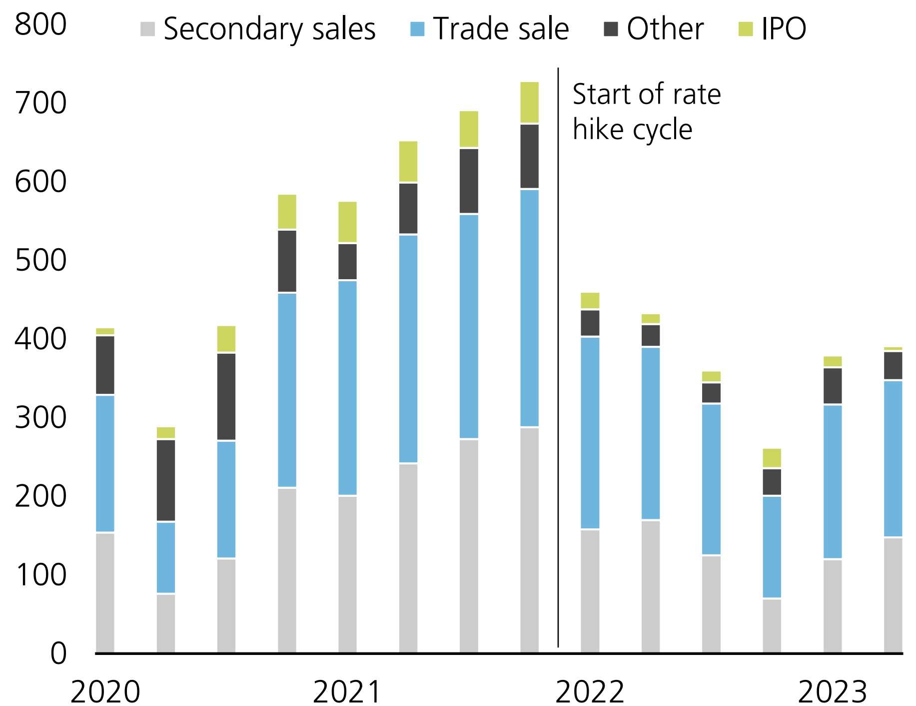
Higher public market valuations and higher borrowing costs have slowed sponsor acquisitions, while a tight IPO window has limited exits.

Sponsors sitting on record amount of dry powder
bn. USD



Source: S&P, Preqin, UBS as of 7 February 2024

Overall exits muted as rates take a bite out of valuations
Number of exits

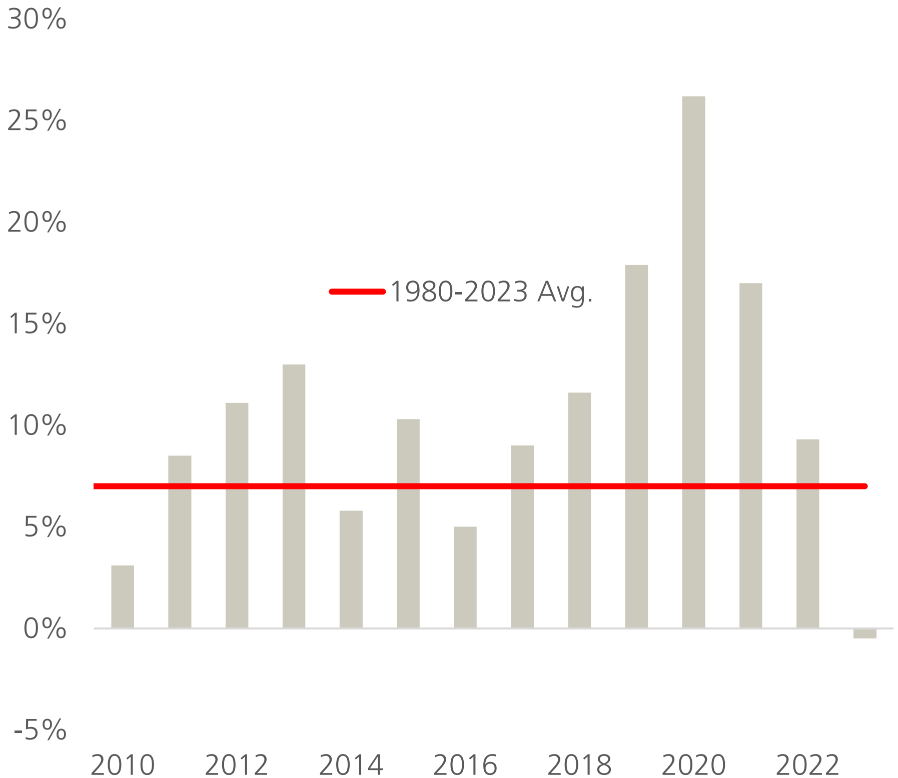


Source: S&P, Preqin, UBS as of 7 February 2024

IPOs: Performance has to improve for the market to open up

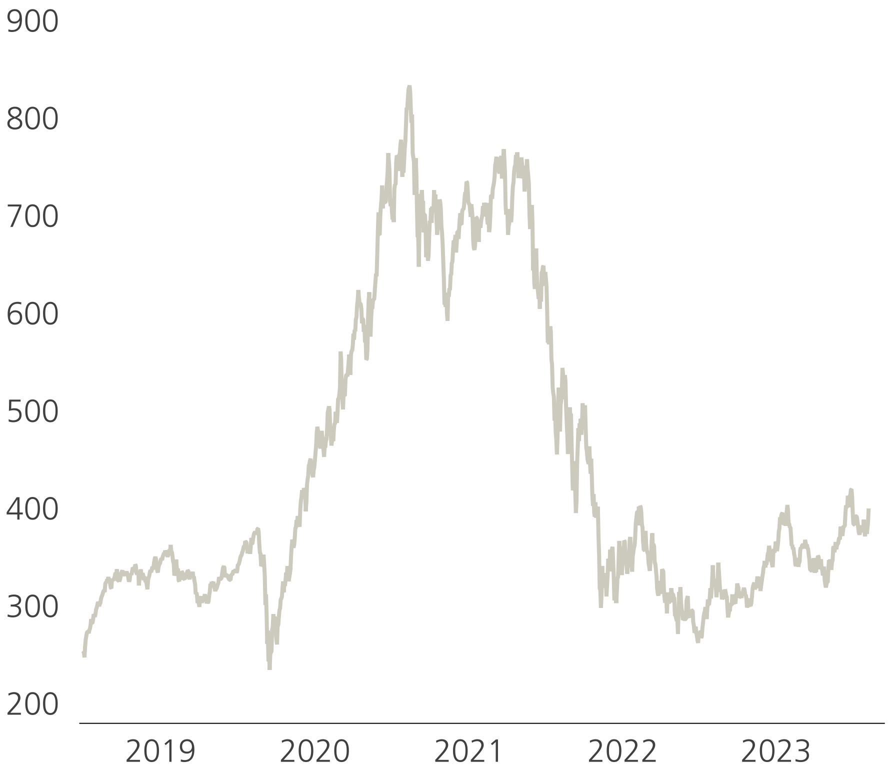
IPOs in 2023 had well below average first-day price pops, while their aftermarket performance has also been lackluster. This return combination is dimming investor interest in new offerings.

IPO first day returns in 2023 were very underwhelming
Median first day returns, %



Source: University of Florida, Bloomberg, UBS, as of 7 February 2024

Renaissance IPO index hasn't done much after 2020-2021 bump
Index

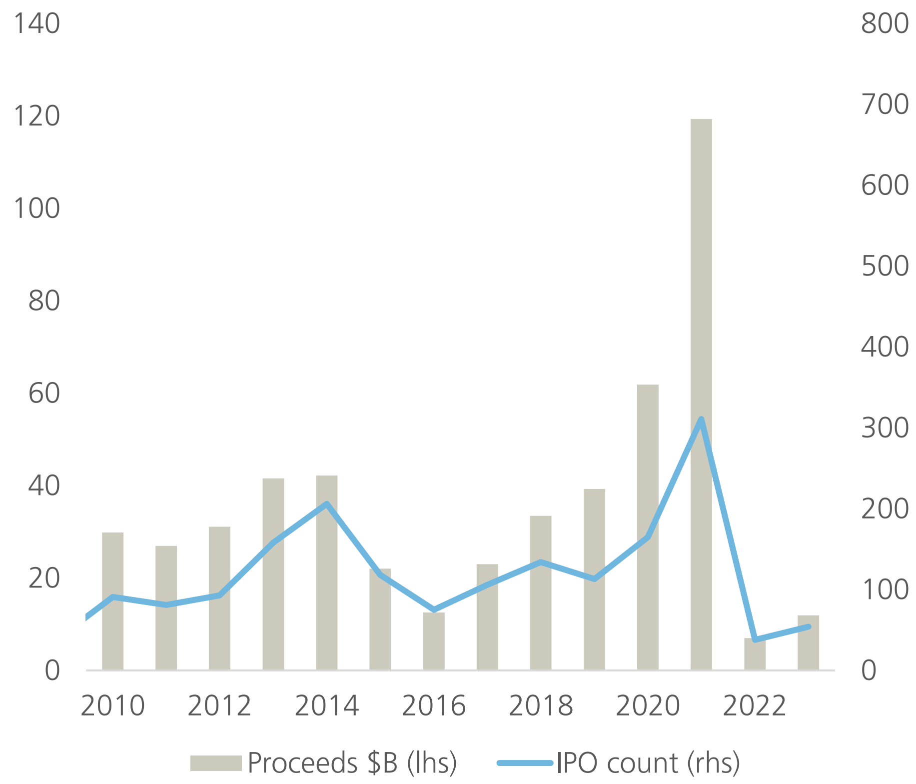


Source: Bloomberg, UBS, as of 7 February 2024

IPOs: Volumes should be higher in 2024, but from a very low base

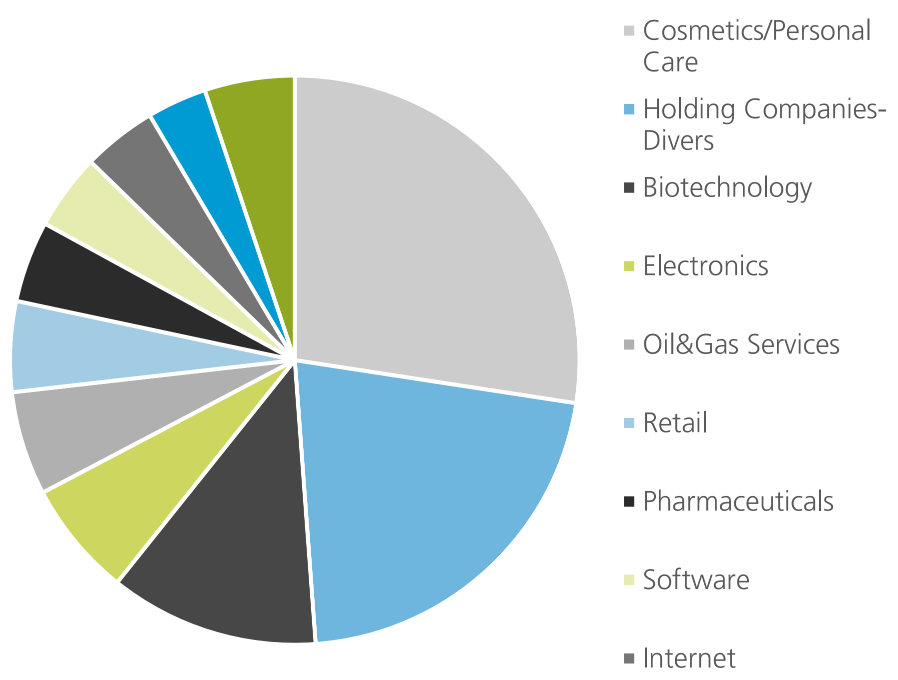
REITS and biotech make up more than 50% of IPO volume in the last year as many other high-profile names wait for 2024 to debut

North American IPO Deal Proceeds
$B and count



Source: University of Florida, ,UBS, as of 7 February 2024

IPOs by sector in 2023
$B

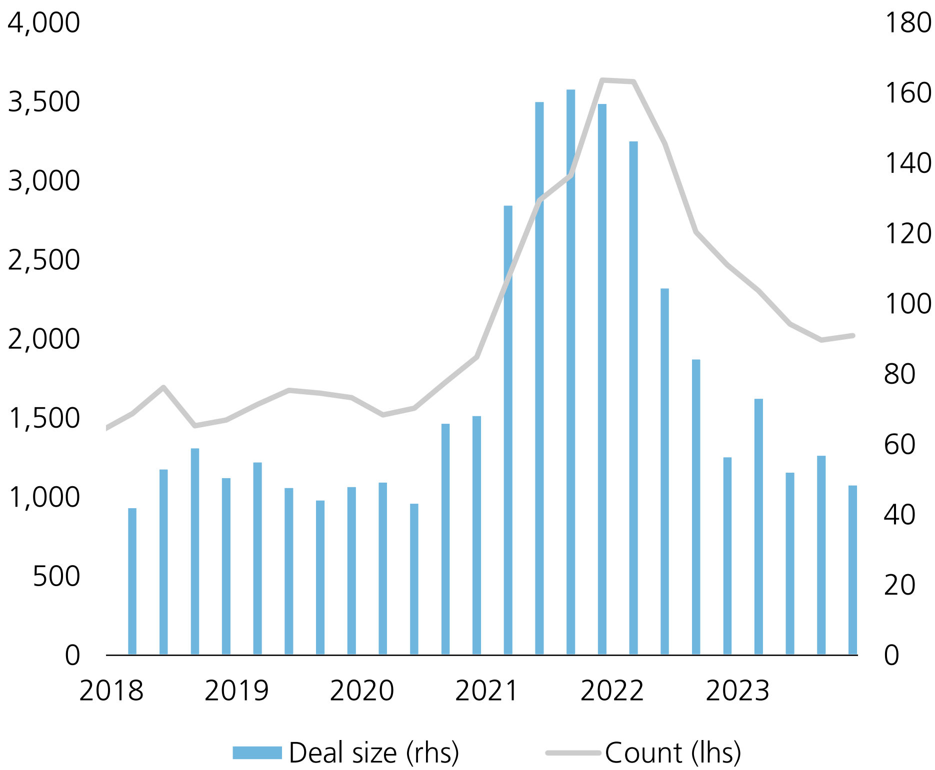


Note: Breakdown from 2022-2023
Source: Bloomberg as of 7 February 2024

Venture Capital: Very muted as high rates deflate valuations

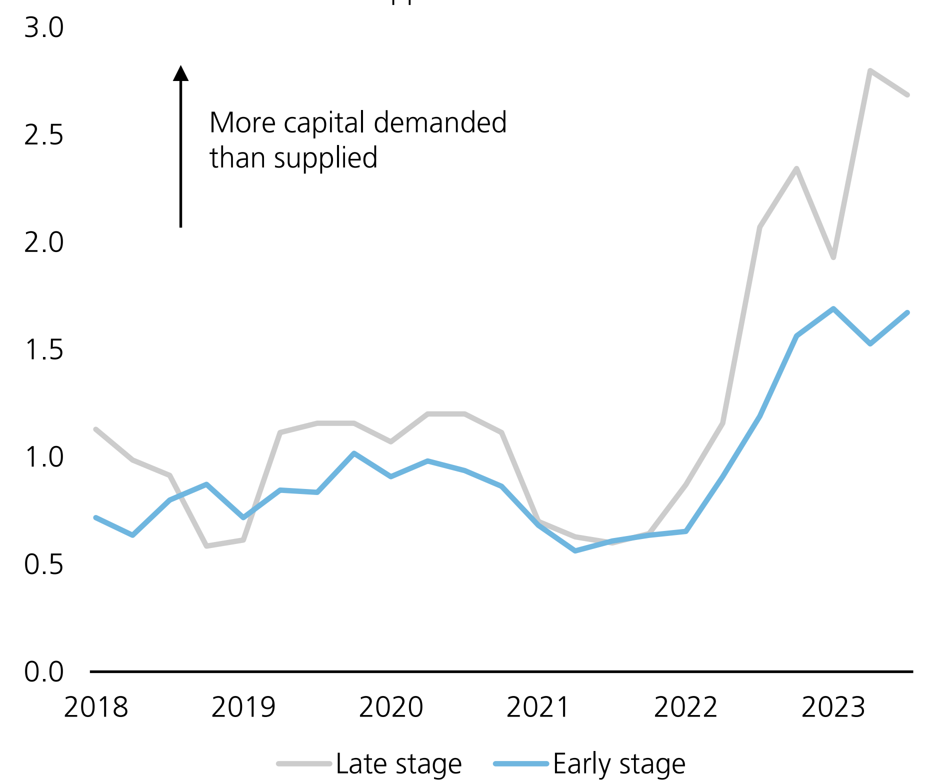
Higher rates, failure of Silicon Valley Bank, and investor uncertainty are all to blame for very low deal activity even as investors remain well-capitalized.

Venture capital deal activity remains muted
Deal value ($B) and count



Source: Bloomberg, UBS, as of 7 February 2024

Start-ups want more capital than VCs are willing to provide
US VC dollars demanded to supplied ratio

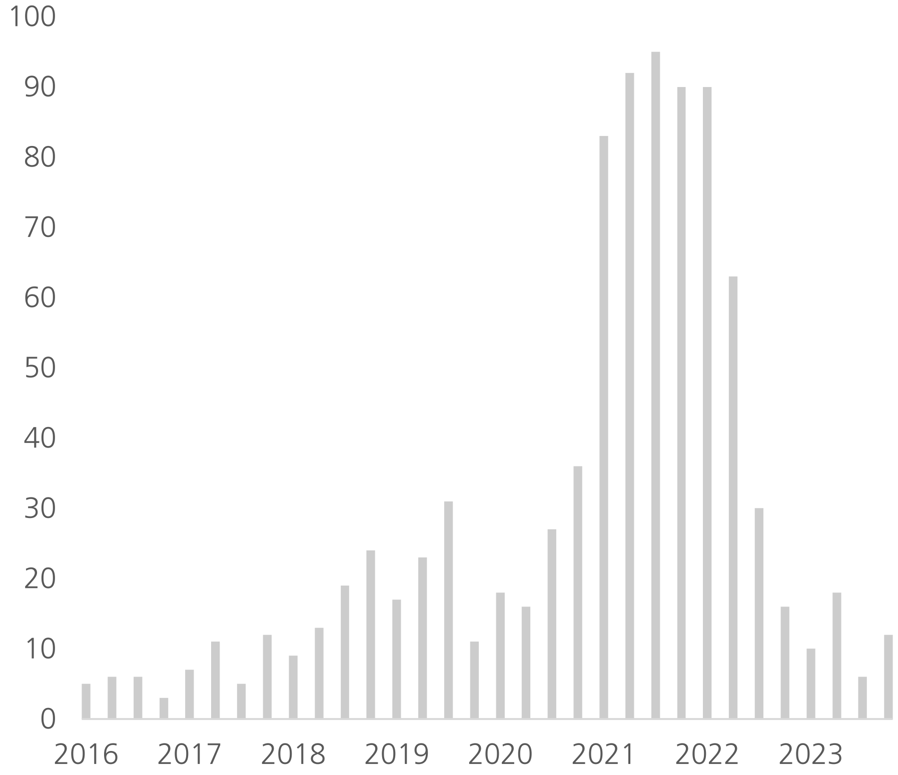


Source: Pitchbook, UBS, as of 7 February 2024

Venture Capital: "Good time to start a business, difficult to grow"

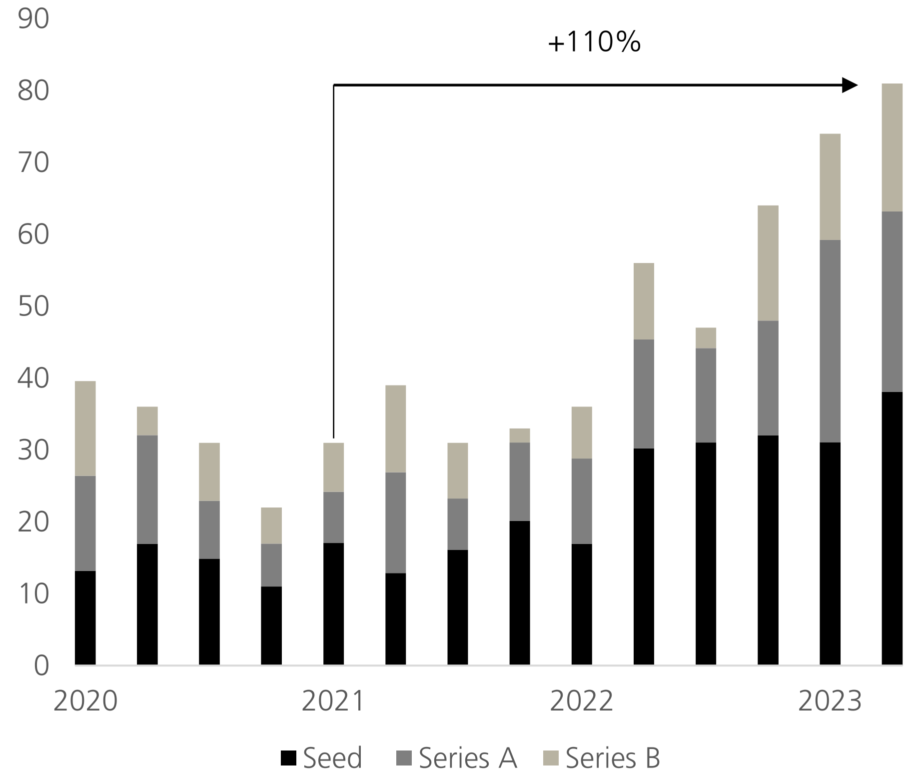
Lack of new funding and longer time between funding rounds has led to an increase in VC-backed company failures, but those that survive are now leaner and more capital-disciplined.

The number of new Unicorns being created has fallen sharply
Number of new North American private companies valued >USD 1bn



Source: Carta, UBS, as of 7 February 2024

Startup dissolutions are up ~100% since Q2 2021
# of dissolutions or bankruptcies by round of funding



Note: Minimum 1 million equity round raised
Source: Carta, UBS, as of 7 February 2024

UBS

Section 6

Sectors update

Sector Views: Tech and Energy currently CIO Most Preferred

Tech: Valuations are rich but reflect strong fundamentals and secular growth. Massive rally from last year have further enriched valuations but reflect strong RoE and fundamentals. Tech company balance sheets still healthy and cash rich. Thus, they should be able to weather a high interest rate environment better than other firms. AI optimism from last year is now transforming into a race to build and commercialize new capabilities, especially in the office/commercial space, spurring imminent investment.

Biotech: Growing green-shoots despite poor financing conditions and negative investor sentiment. The sector has been under pressure since 2021, underperforming broader equities. Smaller-cap firms especially have suffered from a sharp reduction in capital funding after a very strong 2020-2021; sentiment could pick up as financing improves and dealmaking recovers in 2024. Drug price negotiations resulting from the Inflation Reduction Act should be manageable for the industry, implementation is still in the early stages.

Energy: Rising oil prices and continued capital discipline are key themes this year. Lower crude oil prices provided a significant headwind to the sector in 2023, resulting in underperformance against the S&P 500. We expect higher oil and natural gas prices this year, which should support to the overall sector, even as oil price volatility persists amid geopolitical tensions. Firms will likely stay capital disciplined this year, as they focus on improving shareholder returns and reducing debt, while the structural pressure to invest in energy transition remains.

Markets Dashboard: A solid but dispersed start to the year

Negative ← → Positive

Performance	Latest	YTD	Q423	H223	2023
S&P 500	4954	3.6%	11.2%	7.2%	24.2%
IT	3630	7.4%	16.9%	10.1%	56.4%
Software & Services	4546	7.6%	18.4%	12.8%	49.4%
Semiconducors	3773	16.8%	21.1%	18.0%	97.6%
Tech Hardware	3518	-1.8%	11.4%	0.5%	41.3%
Financials	646	2.8%	13.4%	11.6%	9.9%
Banks	351	-0.2%	21.2%	18.1%	7.1%
Diversified Financials	1131	3.3%	12.4%	9.7%	14.0%
Insurance	678	5.8%	6.3%	9.4%	7.3%
Healthcare	1677	4.3%	5.9%	2.7%	0.3%
Pharmaceuticals	1367	6.3%	4.1%	3.7%	-1.5%
Healthcare Eqp.	1960	1.8%	8.4%	1.4%	2.8%
Consumer Discretionary	1416	-0.5%	12.2%	6.6%	41.0%
Discretionary Retail	4193	8.1%	15.7%	11.9%	41.2%
Autos	107	-23.1%	-0.6%	-6.6%	74.4%
Durables	414	-5.2%	21.0%	7.9%	16.8%
Consumer Staples	783	2.5%	4.8%	-2.1%	-2.2%
Consumer Services	1645	0.1%	13.5%	6.3%	28.5%
Staples Retail	745	5.2%	12.4%	8.1%	13.8%
F&B	793	-0.8%	1.6%	-5.9%	-7.5%
HH Products	853	5.8%	2.5%	-5.9%	-6.8%
Communications	270	9.8%	10.7%	13.8%	54.4%
Telecom Services	126	6.4%	14.3%	5.8%	-2.5%
Media & Entertainment	1104	10.2%	10.3%	14.9%	65.6%
Industrials	982	0.9%	12.5%	6.2%	16.0%
Capital Goods	1035	0.6%	14.6%	8.0%	17.2%
Transportation	1028	0.8%	8.6%	0.1%	10.1%
Commercial Services	598	2.4%	8.7%	6.6%	19.1%
Energy	638	-0.7%	-7.8%	2.6%	-4.8%
Materials	520	-5.3%	9.1%	3.4%	10.2%
Utlities	307	-5.0%	7.6%	-3.3%	-10.2%
Real Estate	239	-6.3%	17.7%	6.3%	8.3%

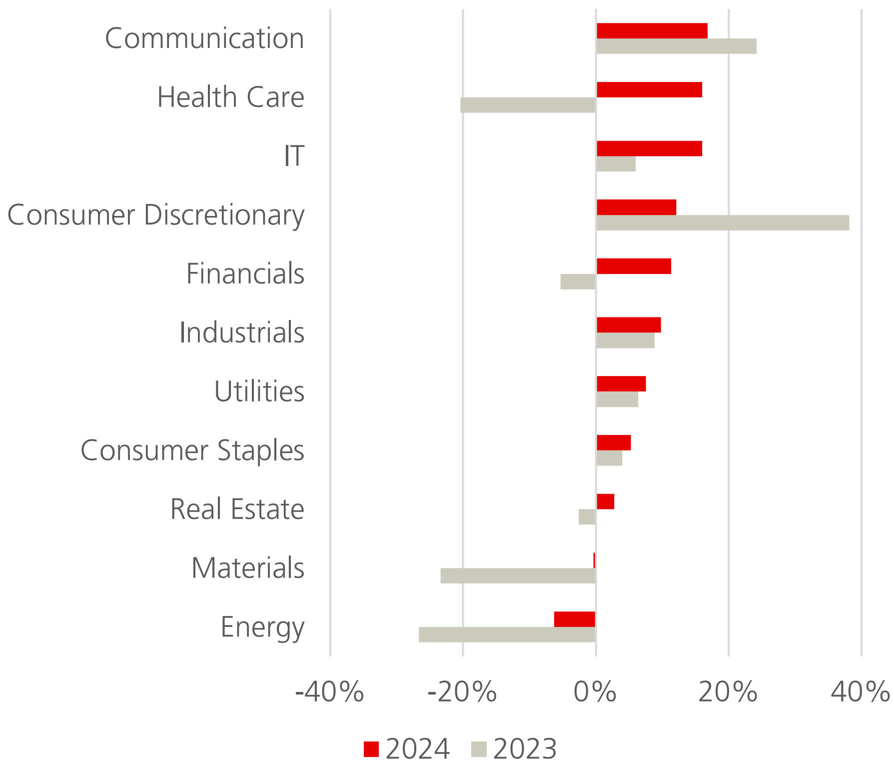
Note: YTD Data through 1/31/2024; Source: Bloomberg, UBS, as of 31January 2024

UBS

Sectors: Valuation and earnings growth dispersion is large

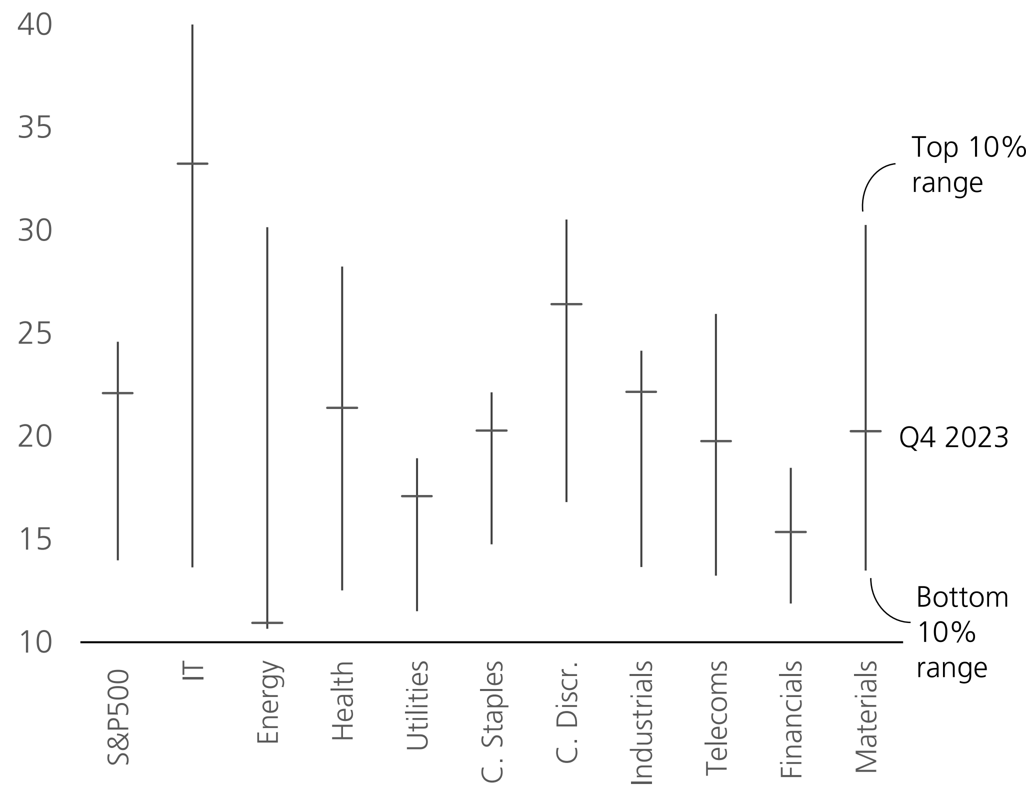
Tech and consumer discretionary trading at upper half of 30-year range while real estate and energy trading at bottom of ranges. But this mirrors earning expectations

Earnings growth rates
year/year, %



Source: Bloomberg, UBS, as of 7 February 2024

Historical P/E ratios since 1990 for S&P GICS sectors
%



Note: Real Estate sector was not included;
Source: Bloomberg, UBS, as of 7 February 2024

UBS

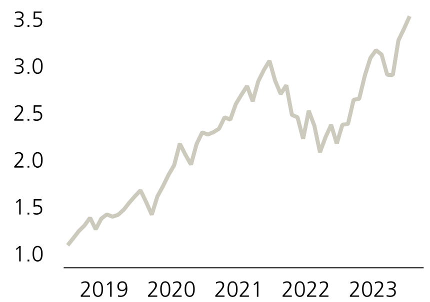
Sector Snapshot: Tech

Summary

- Tech stocks still expensively priced, with valuations trading near the highs that occurred during the pandemic.
- Overall, the sector should benefit from bottoming in PC and smartphone end-markets and positive earnings revisions.
- US tech sector companies have strong balance sheets, which should insulate them from high rates and slower economic growth.
- AI optimism as cooled, leading to more attractive valuations; UBS CIO expects a 72% CAGR from 2022-2027 – AI monetization basis for y/y EPS growth forecast of 18% in 2024.
- Tech M&A to improve in 2024 after a dismal 2023, but higher regulation to curb "mega-deals"

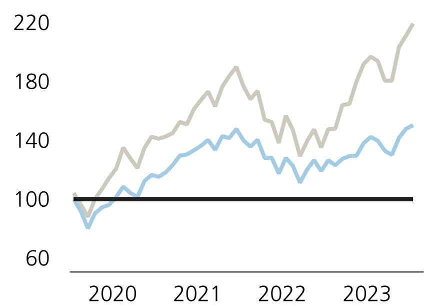
Market Performance

S&P Subsector performance
in tsds.



Source: Bloomberg, UBS, as of 7 February 2024

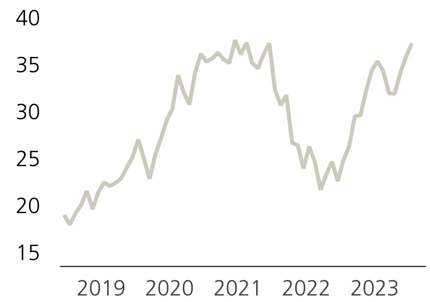
Relative Market Performance
Rebased 12/31/2019 =100



Source: Bloomberg, UBS, as of 7 February 2024

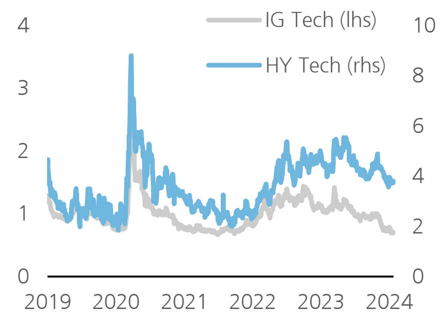
Valuations

P/E Ratio
%



Source: Bloomberg, UBS, as of 7 February 2024

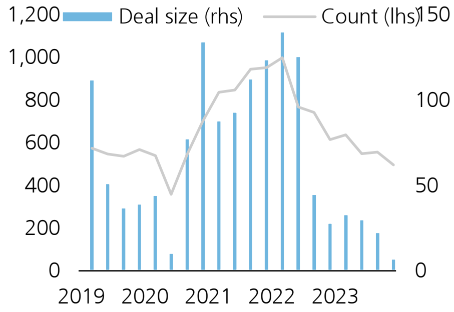
Spreads
%



Source: Bloomberg, UBS, as of 7 February 2024

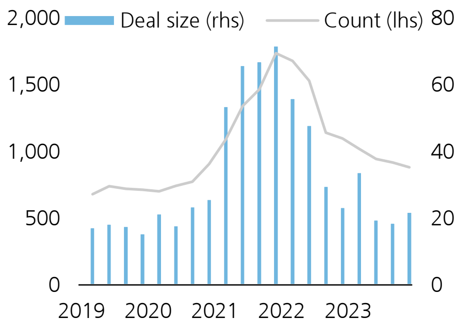
Corporate Transactions

M&A
$B and count



Source: Bloomberg, UBS, as of 7 February 2024

Venture Capital
$B and count



Source: Bloomberg, UBS, as of 7 February 2024

UBS

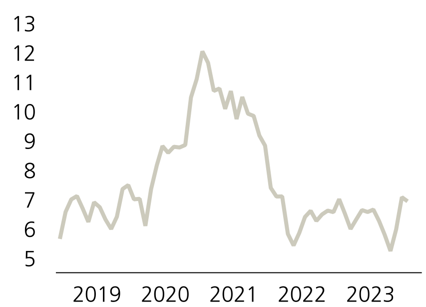
Sector Snapshot: Biotech

Summary

- Biotech struggled in 2023 lagging behind roader equity indices thanks to a challenging macroeconomic environment and negative bias from clinical / regulatory events.
- Depressed capital market activity background disproportionately a headwind to developmental-stage companies.
- Still, most investors are bullish on biotech sector expecting it to outperform broader equities indices 2024.
- Gene therapy remains an elusive catalyst for the sector but regulatory concerns would be the overhang.

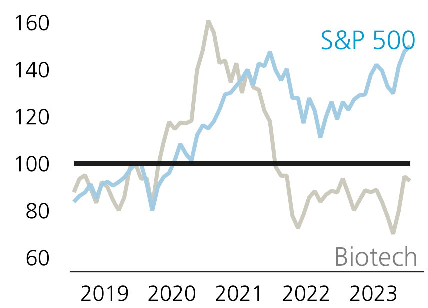
Market Performance

S&P Subsector performance
in tsds.



Source: Bloomberg, UBS, as of 7 February 2024

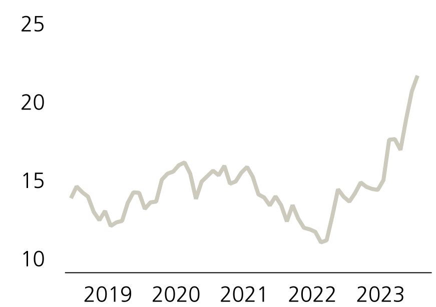
Relative Market Performance
Rebased 12/31/2019 =100



Source: Bloomberg, UBS, as of 7 February 2024

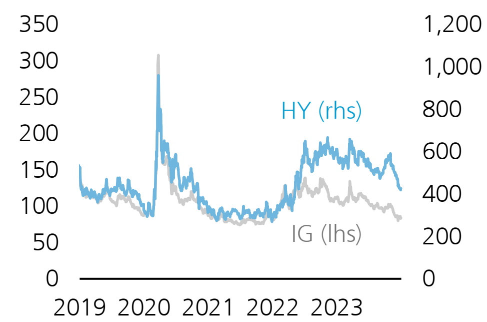
Valuations

P/E Ratio
%



Source: Bloomberg, UBS, as of 7 February 2024

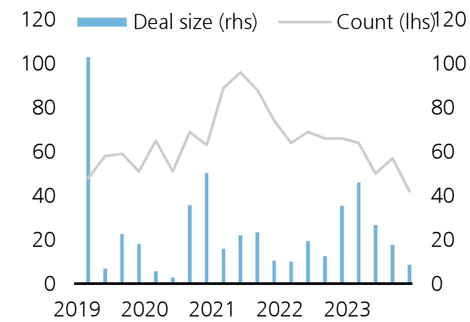
Spread
bp



Note: Biotech spreads not available so Healthcare sector spreads were used
Source: Bloomberg, UBS, as of 7 February 2024

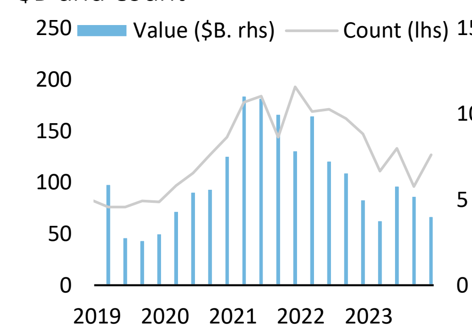
Corporate Transactions

M&A
$B and count



Source: Bloomberg, UBS, as of 7 February 2024

Venture Capital
$B and count



Source: Bloomberg, UBS, as of 7 February 2024

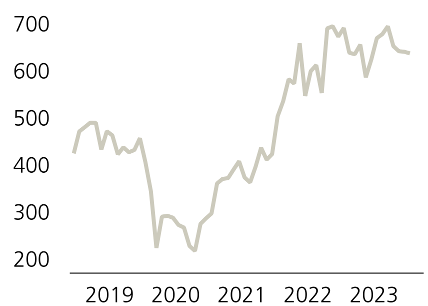
Sector Snapshot: Energy

Summary

- Energy companies have remained focused on capital discipline and improving shareholder value, but not enough to offset trend in lower oil prices.
- Oil prices to recovery to a USD 80-90 range in 2024 but liquid natural gas investors may have to wait until 2025 to see positive returns
- US production has been higher than expected even in the face of smaller capital budgets and declining rig counts.
- Company fundamentals are strong; balance sheets in energy sector very strong relative to other sectors and its own history.

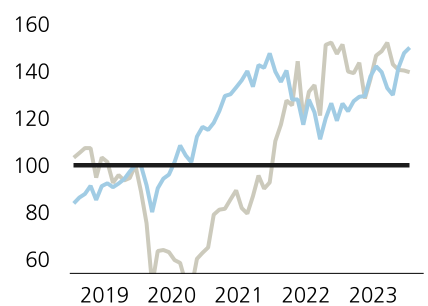
Market Performance

S&P Subsector performance
in tsds.



Source: Bloomberg, UBS, as of 7 February 2024

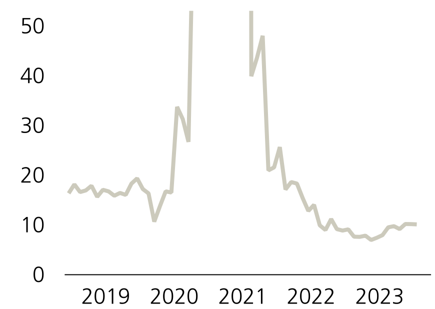
Relative Market Performance
Rebased 12/31/2019 =100



Source: Bloomberg, UBS, as of 7 February 2024

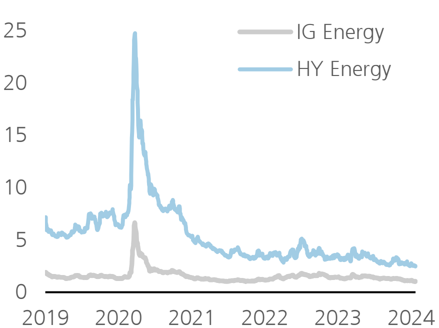
Valuations

P/E Ratio
%



Source: Bloomberg, UBS, as of 7 February 2024

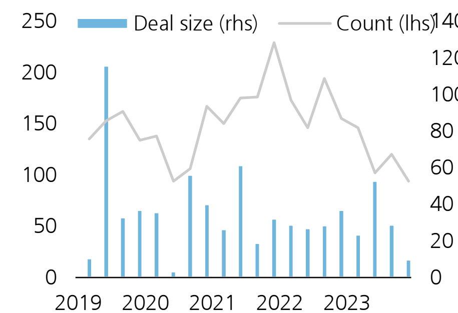
Spreads
%



Source: Bloomberg, UBS, as of 7 February 2024

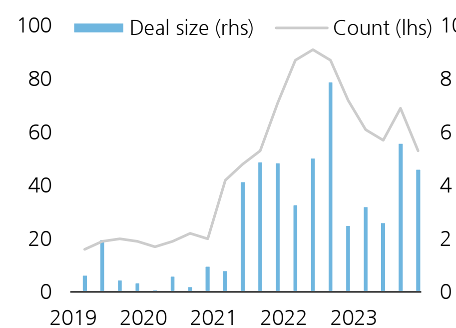
Corporate Transactions

M&A
$B and count



Source: Bloomberg, UBS, as of 7 February 2024

Venture Capital
$B and count



UBS

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